

## Funding Higher Education in England: What are the Options?

### **Submission by the Russell Group of Universities to the Independent Review of Higher Education Funding and Student Finance May 2010**

#### **Executive Summary**

- I The Russell Group's previous submission to the Review showed there is a pressing need to increase funding for the UK's research-intensive universities if they are to secure a sustainable future and continue to compete alongside leading universities around the world.
- II The UK higher education sector creates far-reaching benefits for the public, private individuals and businesses, and is funded by a mix of public and private investment. Within this funding model, there are a number of possible sources of increased investment for universities. However, while it is important to explore all options, this document shows that public funding is constrained, while opportunities to increase income from business contributions and to reduce costs through efficiency savings will in themselves be insufficient to ensure sustainability.
- III This submission shows that an increase in graduate tuition contributions from full-time home and EU undergraduates at institutions in England represents the only viable option for ensuring sufficient funding for a world-class higher education system, in a manner that is fair, sustainable, and protects access. It shows that there is currently an imbalance in funding for higher education. Taxpayers still foot the lion's share of the costs, although the benefits are enjoyed disproportionately by the better-off. Graduates should be expected to contribute more in view of the substantial private benefits they secure through attending university, particularly from certain programmes.
- IV An increase in graduate contributions should be additional to a continued commitment by Government to maintain public investment in higher education. To secure the long-term financial sustainability of the country's leading universities, it will be necessary to increase overall levels of investment, not simply to replace public funding with increased levels of private investment. This would continue to recognise the wider benefits to society from higher education and graduates.

- V An increase in graduate contributions will also facilitate a more differentiated market in higher education. This will create a fairer system in which the graduates who secure the greatest benefits will make the greatest contribution, and where diverse models of teaching and learning can be efficiently supported. Graduate contributions also provide more incentives for institutions to improve quality and responsiveness to students' needs as they encourage students to be more demanding of their universities.
- VI Public funding to universities for teaching should also be reformed to recognise better the diversity and costs of higher education provision. This will be particularly important in a more differentiated market where the level of public funding for a student should be a factor of the cost of providing the course, the private return, and public return, so that no student is deterred from taking strategically important courses, like STEM, which are expensive to provide.
- VII The most effective and efficient way of protecting quality while ensuring long-term sustainability and global competitiveness would be to allow institutions to determine the level of all fees for all undergraduates and not just postgraduates, part-time and international students; but we recognise that it is likely to be more appropriate and acceptable to many to have an incremental approach to removing the fee cap.
- VIII An increase in the financial contributions made by graduates and greater differentiation in the level of contributions between different courses or institutions must be accompanied by better and clearer information for prospective students. Clearer information should be provided about the financial support available to them and the quality of education, the kind of experience, and the likely returns associated with different universities and courses.
- IX Concerns around raising additional investment from graduate contributions have tended to be focussed in two other areas. Firstly, that increasing costs for graduates would harm access to higher education if attending university is perceived to be expensive by some students. Secondly, that the additional burden placed on the public purse by the cost of student loans to cover higher graduate contributions would be unaffordable for the Government. This submission shows that both of those concerns can be fully overcome.
- X It is essential that all students, regardless of family background, have fair access to higher education, and to the UK's leading universities. As discussed in our previous submission to this Review, research has clearly shown that higher graduate contributions need not have a negative impact on access or widening participation in higher education. Indeed, when combined with an effective system of student support, increased graduate contributions can promote widening participation and fair access. This submission sets out how a system of student loans can be developed which is sustainable and capable of supporting higher graduate contributions, whilst maintaining fairness and cost efficiency and safeguarding access.
- XI The student support system should be reformed to remove over-generous and regressive 'deadweight' subsidies, reduce overall costs and target support more effectively on those who need it most. It should be reformed through the introduction of a real rate of interest, and increased repayment rates. By incorporating these measures into a new system, the Government could support loans to cover significantly higher levels of graduate contributions, without increasing long-run costs.

- XII Moreover, if the public purse cannot support a significant increase in lending, then there are feasible options to fund loans to cover additional graduate contributions (i.e. fees and student support costs above the current cap of £3,225) through private sector finance. This submission briefly outlines several models for doing this which merit further consideration. In the first, the student loans company would continue to provide income-contingent loans to students, but would finance this lending by selling bonds linked to graduate repayments to private investors. In the second, individual universities or groups of universities would raise funds by selling bonds linked directly to graduate repayments, or annuities funded by future graduate repayments. The third explores the possibility of banks providing income-contingent loans to individual students.
- XIII This submission proposes that a system of privately funded lending could be designed which would limit public spending while meeting the following essential criteria:
- No student is required to pay for higher education up-front
  - Access is protected to ensure all people with the ability and who wish to benefit from higher education are able to do so.
  - Graduate contributions remain income-contingent
  - Universities are able to secure additional up-front funding from private investors on the basis of future graduate contributions
  - The student finance system is affordable for Government
- XIV A graduate 'tax', as opposed to price-limited graduate contributions, has sometimes been proposed as a 'fairer' alternative. This submission shows that such a system would offer little or no benefit to graduates (while greatly increasing costs for many), would be fiscally unsupportable, and would fail to facilitate the increases in quality made possible by a more differentiated market in higher education.
- XV The options proposed in this submission address the key criteria set out by the Review in its call for evidence.

*They ensure sustainability for higher education by:*

- Increasing funding for universities through higher graduate contributions
- Reducing the costs of the student support system
- Limiting public borrowing by providing ways to incorporate private finance within the student support system

*They will enhance quality, efficiency and innovation in the UK higher education system by:*

- Providing resources to improve the quality of teaching and learning, and the student experience, through investment in lowering student-staff ratios and enhancing technology-enabled learning
- Providing sufficient funding to ensure the sustainability of a cadre of world-class universities
- Encouraging a truly variable pricing regime which will fund different types of higher education provision more efficiently
- Giving students a stronger voice in demanding a high quality education during their time at university
- Combining higher financial contributions with much clearer information to prospective students about the student experience they can expect and the benefits they will receive from their degree, giving universities more incentive to invest in providing the best possible experience for their students.

- Giving universities a more direct financial interest in the future success and earnings of their graduates, thereby providing an additional incentive for them to invest in the best possible education for their students.

*They support participation by:*

- Providing resources for investment in innovative access initiatives.
- Reducing student support costs, reducing the limits on student numbers (although we believe that improving quality is a greater priority than expanding numbers).
- By reducing costs, allowing the student support system to be extended, if desired, to cover students other than full-time undergraduates.
- Retaining a student support system that ensures higher education is free at the point of entry, graduates make payments which are affordable, and subsidies are targeted to those most in need.
- Providing better and clearer information to prospective students about the financial support available to them and the benefits they can expect to receive from higher education.

# 1. Introduction

- 1.1 This submission to the Independent Review of Higher Education and Student Finance briefly sets out a number of possible options for the future funding of higher education in England. In line with the key priorities set out by the Review, these proposals are designed to secure a higher education system which is sustainable in the long-term, capable of continuing to deliver world-leading research and teaching and safeguarding participation for all who can benefit from it.
- 1.2 Further investment in research-intensive universities will be needed in the future if the UK is to continue to benefit from having some of the world's best universities. Students, employers and the wider society benefit enormously from the UK's research-intensive universities, and their continued success will be critically important to the country's future growth and prosperity.
- 1.3 The difficulties facing universities have been set out in our previous submission to the Review. It showed that the UK higher education sector is underfunded with respect to its international competitors and that the current system is failing to provide sufficient funding to support our world-leading research universities. Further investment is urgently needed if recent progress is to be sustained, and the long term competitiveness of the UK's research-intensive universities assured.
- 1.4 This submission explores the potential solutions to this funding shortfall and advocates an increase in contributions from graduates. It offers some possible variants on the best and fairest ways in which this could be achieved.
- 1.5 In line with the criteria set out by the Review, we believe there are some key principles which should be adhered to in considering the future funding of higher education. These are:
  - I. Sufficient funding: The best UK universities must be able to access adequate resources to continue to operate at a world-class level.
  - II. Efficient funding: Higher education funding should drive up quality whilst efficiently funding diverse modes of higher education. There is significant variation in the education offered by different institutions and different courses. Funding for higher education should incorporate a system of variable pricing and funding better able to recognise these differences.
  - III. More sustainable and efficient student support: The current system of student support contains significant subsidies which are regressive and do not benefit those most in need. Moreover, the subsidies do not address key determinants of participation in higher education. These are primarily a student's academic achievements and, secondly, his/her aspirations and access to good advice. The system should be rendered more sustainable and more progressive by eliminating the 'deadweight' of subsidies currently received by those who do not need them.
  - IV. Clearer information and guidance: A system of variable pricing should provide further incentives for universities to drive up the quality of the experience they offer students. In addition, students should be offered clearer information about the kind of education they are likely to receive from different courses and institutions, and where they are likely to secure the greatest returns on the investment they make in their education. This requirement becomes particularly pressing if in the future graduates are asked to contribute more towards costs.

V. *Ensuring a fair contribution to the costs of higher education from the key beneficiaries (the state, graduates, employers)*: Currently the Government is by far the greatest contributor to the costs of higher education. Institutions are seeking to work more closely with businesses, but the additional funding which can be secured through doing so is likely to remain limited. Most graduates themselves benefit significantly from higher education, and there is therefore a strong case for increasing graduate contributions towards the cost of higher education.

1.6 The first part of this submission looks at the existing sources of income for universities and shows that both public funding and many private funding sources, such as income from businesses or fees paid by international students, will be increasingly constrained in the short to medium-term. They will therefore be insufficient to deliver the substantial increase in investment which leading universities need to remain competitive.

1.7 Subsequent sections then show that graduate contributions are an important and necessary part of the funding environment, and the fairest and only viable option for securing long-term sustainability. By improving the current system of student support, providing better information to students, and taking a considered approach to alternative options such as private finance for student loans, the long-term sustainability of universities can be assured, while protecting a world-class higher education system that is fair and accessible to all who can benefit from it.

1.8 Russell Group universities are firmly committed to attracting and educating the very best students, regardless of background or financial circumstances. This principle underpins all of the options considered within this submission in relation to the future of student finance.

1.9 For each of our proposed options, we have summarised how it meets the four key questions asked by the Review in its 'Call for Proposals'.

## **2. Research-intensive universities face an urgent need for increased investment, which cannot be met from existing income sources**

- 2.01 The Review has called for proposals which will ensure the long-term sustainability of higher education. This section shows that both public funding and a wide range of private sources of funding will be important components of a future funding system. However, they will not be sufficient to safeguard a sustainable future for universities.
- 2.02 As discussed in our previous submission to the Review, within the current system of higher education funding it is difficult to see how research-intensive universities will be able to avoid a retrenching and reduction in core activities that could fundamentally undermine their quality and international reputation. Identifying a fair and sustainable means of raising the level of investment in universities is therefore critical to securing the future of a world-class higher education sector in the UK.

### **2.1. Public funding is severely constrained, and likely to remain so for the foreseeable future**

- 2.11 The public benefits which higher education confers on the UK are substantial and wide-ranging, justifying a significant level of public investment. However, the state of the public finances since the credit crisis of 2008 means that significant increases in public investment in higher education would seem highly unlikely in the foreseeable future.
- 2.12 It should be noted, however, that the reduction of public funding for universities is not a universal policy response to the current economic downturn. Whilst UK universities have faced cuts, the response in the Far East has been the opposite. China, South Korea, Taiwan and Singapore are increasing their public investment in universities, and this surge is accompanied by increasing investment in higher education by students and families.<sup>1</sup> As the global economic centre of gravity shifts to the east, these (and other) countries will increasingly be key competitors for the UK in attracting the very best students and academic talent from around the world. At the same time, many of the UK's 'older' competitors, including the United States, France, Germany and Australia, have all poured funding into higher education and research, in a bid to kick-start their economic recovery.<sup>2</sup>
- 2.13 In the UK, higher education has already borne a significant share of the cuts to be made in public expenditure, and it will be vital to the future health of the sector and the economy that further reductions in public funding are avoided as far as possible. To secure the long-term financial sustainability of the country's leading universities, it will be necessary to increase overall levels of investment, not simply to replace public funding with increased levels of private investment.
- 2.14 The funding shortfall which universities now face and which threatens their future international competitiveness cannot be met solely through more investment by the taxpayer. Furthermore, as discussed in detail later, it would be both inequitable and inefficient to seek to place the burden of raising investment in higher education entirely upon the general taxpayer.

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<sup>1</sup> Simon Marginson, *Polar funding policies are closing the gap between East and West*, THE, 21 Jan 2010

<sup>2</sup> See the Russell Group publication *Staying on top: The challenge of sustaining world-class higher education in the UK* for a more detailed overview of international investment in higher education

## **2.2. Alternative private income sources will be part of the solution, but they remain limited.**

- 2.21 Universities are constantly seeking to diversify their income streams. The Russell Group publication, *Staying on top: The challenge of sustaining world-class higher education in the UK*, discusses the likelihood of universities securing more income from three key sources of private investment: endowments and charitable contributions, collaboration with business, and international activities. All will continue to be important for Russell Group universities, but will not be sufficient on their own to provide universities with the additional resources they require in the future.

### *Endowments and charitable contributions*

- 2.22 Russell Group universities have had considerable success in growing income from philanthropic sources on the back of substantial efforts to increase engagements with alumni and to establish fundraising campaigns.<sup>3</sup> In the long-term, contributions and investments from alumni and endowment income may well play a greater role in the financing of UK universities. Indeed, some of the models of privately-financed student support discussed below would create opportunities for alumni to invest in their former institution.
- 2.23 For the time being, however, such funds represent a very small proportion of university income. It takes time to build up endowments and alumni relations, and a significant increase in income from these sources will require a sustained effort over a number of years. It is also more difficult to increase philanthropy during an economic downturn. In the short- to medium-term, therefore, income from philanthropic sources will not be sufficient to form a major part of the solution to the funding shortfall.

### *Income from business*

- 2.24 Russell Group universities have greatly expanded their engagement with and income from business in recent years. Businesses will continue to be important partners across both research and teaching activities. In its publication *Stronger Together*, the CBI's higher education task force reported that "business will need to engage and invest more effectively with students and universities."<sup>4</sup>
- 2.25 Yet the ability and willingness of businesses to invest in universities is likely to be constrained in the aftermath of a recession. Despite significantly increasing their level of engagement with business, funding from the private sector remains a relatively small proportion of university income.<sup>5</sup> Commercially-funded research is often funded at less than the full economic costs<sup>6</sup>, contributing to an overall shortfall and backlog of investment in research.

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<sup>3</sup> Ross-Case survey 2006/07 – Final Report November 2008

<sup>4</sup> CBI, *Stronger Together: Businesses and universities in turbulent times*; September 2009

<sup>5</sup> Funding from the private sector constitutes an average of 2.8% of total income within Russell Group universities (Source: HESA Finance 2007/08; Finance Returns - Income Analysed by Source).

<sup>6</sup> See: RCUK/UUK *Review of the Impact of Full Economic Costing on the UK Higher Education Sector* (April 2009) section 8.2. <http://www.rcuk.ac.uk/review/fec/default.htm>



- 2.26 Income from the sale or licensing of intellectual property does represent a source of genuine additional and non-hypothecated income, but it currently constitutes, on average, just a quarter of 1 percent of university income.<sup>7</sup> Successful commercialisation of research can take many years, is unpredictable, and cannot be relied upon to provide regular income to universities.<sup>8</sup> More importantly, there is a danger that undue focus on this source could endanger the sector's wider mission to generate and disseminate new knowledge.
- 2.27 There is a convincing argument for further investment from employers to be made in many aspects of university education. This is most obviously applicable in the case of more vocational courses, where there are clear and specific benefits to particular sectors of industry. Significant cost-sharing between employers and the Funding Council already occurs in specific areas (for example, the NHS contributes to a large proportion of the costs of undergraduate medicine). There are also examples of universities across the sector, including Russell Group institutions, collaborating with employers to fund very specific, vocationally oriented higher education, such as Newcastle University's Flying Start accountancy degree developed with PriceWaterhouseCoopers.<sup>9</sup> There may therefore be some scope to expand cost-sharing with employers within those sectors which are most reliant on graduates from specific subjects or courses. This is likely to be of greatest relevance to universities which offer a large proportion of vocational degree courses.
- 2.28 However, seeking to increase the overall contribution which businesses make poses challenges. Employers argue that they already contribute indirectly to the costs of higher education through taxes and the higher wages paid to graduates. Richard Lambert has noted in evidence to the Review that businesses will only be willing to contribute to the cost of programmes from which they receive clear benefit, and at a clearly defined price related to cost. Businesses will not want to cross-subsidise standard teaching and research.<sup>10</sup> This fact is only likely to be reinforced within a difficult financial climate. Moreover, within an increasingly mobile labour market businesses will be less willing to cover the costs of employee training, because they will be unlikely to benefit from the skills of those employees for a sufficiently long period.<sup>11</sup>
- 2.29 For these reasons, it is likely to prove difficult to achieve a significant increase in business contributions to higher education, short of levelling a general tax increase upon them. It should be recognised that, particularly in the current financial climate, such a move would likely prove deeply unpopular and perhaps harmful to the UK's economic growth.

### *Expansion of international activities*

- 2.210 International activities, and the flow of international students in particular, have provided an important income stream for Russell Group institutions.

<sup>7</sup> Source: HESA Finance 2007/08; Finance Returns - Income Analysed by Source

<sup>8</sup> More information about universities' collaborations with business, and the commercialisation of research is available in the publication: The Russell Group *The economic impact of research conducted in Russell Group universities* (March 2010) ([www.russellgroup.ac.uk](http://www.russellgroup.ac.uk))

<sup>9</sup> For this and other examples of Russell Group universities working alongside employers in providing higher education, see *The Employability of Russell Group Graduates – Employer perspectives and the activities of Russell Group universities*; Russell Group Briefing Paper (forthcoming)

<sup>10</sup> See oral evidence on the Independent Higher Education Review website: <http://hereview.independent.gov.uk/hereview/2010/02/videos-of-public-hearings/>

<sup>11</sup> Barr, N, *Paying for Higher Education: what policies in what order?* Submission to the Independent Review of Higher Education Funding and Student Finance; February 2010

- 2.211 The international student market is diverse and future trends in demand will differ between countries and regions, and between undergraduate, postgraduate taught and postgraduate research students. Nevertheless, it seems likely that the recent trend of growth in overall numbers of internationally mobile students will continue in the immediate future. As one of the world's leading destinations for international students, the UK is well placed to benefit in the short-term from this upward trend.
- 2.212 However, universities in this country cannot be reliant on international students as a primary source of additional income in the medium- to long-term. While Russell Group universities, and the UK sector as a whole, have been extremely successful in attracting international students, recent reports suggest they may struggle in the future to maintain their global market share against increasingly fierce competition from overseas.<sup>12</sup> As countries such as India and China invest in developing their own higher education institutions rather than in educating large numbers of students abroad, the overall growth in students seeking to study outside their country of origin is also likely to slow. Indeed, the number of Chinese students studying abroad has declined since 2002, and is now lower than the number of foreign students studying in China.<sup>13</sup> These developments indicate that growth in international student numbers may reach a peak in the near future, after which time the challenge for the UK will be to preserve its market share and retain current numbers.
- 2.213 Attempting to raise investment by simply increasing overseas student fees would also be extremely risky. If UK universities are perceived to be interested in international students purely for the purpose of subsidising an under-funded higher education system, this would irreparably damage their reputation overseas. The experience of Australia in recent years shows how over-dependence on international students as a solution to funding shortfalls can have a negative impact on a higher education sector. An over-reliance on the income secured through international student fees led to accusations of reductions in quality, as well as leaving Australian universities vulnerable to shifts in their market share of international students.<sup>14</sup>
- 2.214 Russell Group universities have also expanded the level of trans-national education (TNE) they provide, the most high-profile example being the development of international campuses. However, while TNE can be an important part of a university's strategy to develop international links and expand its profile overseas, such international ventures can be very resource-intensive and carry significant risk for institutions. For the UK's research universities there are also particular challenges in establishing TNE which is consistent with the research-led teaching model so fundamental to their mission. Therefore, such international activities do not in themselves represent a reliable means to generate significant additional revenue.

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<sup>12</sup> Bone D, *Internationalisation of HE, a ten-year review*. London: Department for Innovation, Universities and Skills (2008).

<sup>13</sup> Figures quoted in Zhao, L.T. and Sheng, S.X. *China's 'Great Leap' in Higher Education*. EAI Background Brief No. 394 (24 July 2008).

<sup>14</sup> For a useful overview see *'Rankings and Internationalisation' Sustainability and risks of internationalisation*; Professor Simon Marginson, presented at The Australian Financial Review Higher Education conference 13-14 March, 2008: Amora Hotel Jamison, Sydney

### 2.3. Universities are committed to cost-effectiveness and efficiency, but this cannot be the solution to under-investment

- 2.31 As discussed in our earlier submission to the Review, universities have demonstrated a strong track record in increasing cost-effectiveness.<sup>15</sup> During the 1990s, when funding was constrained, some of the financial pressure was absorbed by institutions becoming more efficient. Cost savings worth millions of pounds were delivered through increased sharing of resources and equipment, better use of staff and space, and new economies of scale achieved through university growth and mergers. As a result, UK universities are now among the most efficient of any nation within the OECD.
- 2.32 Despite below average expenditure on higher education, as a proportion of GDP, the UK has higher than average graduation rates,<sup>16</sup> and some of the highest completion rates of any OECD country, behind only Japan and Denmark.<sup>17</sup> Significantly, UK universities graduate students over a much shorter time than the average among OECD countries with 97% of UK students graduating within 3-5 years, compared to just 64% among OECD countries on average. Yet the wage premium secured by UK graduates is well above the OECD average (seventh largest amongst OECD countries measured).<sup>18</sup> Research indicates that graduates from Russell Group universities secure an average earnings premium of at least 6% over the rest of the UK sector<sup>19</sup>, giving Russell Group graduates an earnings premium among the highest within the OECD.<sup>20</sup>
- 2.33 These outcomes have been achieved alongside outstanding productivity and efficiency in university research. With 3% of global R&D investment, the UK publishes 14.4% of the world's highly cited publications.<sup>21</sup> It is also the most efficient country in the G8 in terms of the ratio of citations to public funding.<sup>22</sup>
- 2.34 Russell Group universities continue to pursue innovative ways to deliver greater cost-effectiveness and higher levels of productivity. Recent programmes of cost reductions and efficiency savings have resulted in significant reductions in staff expenditure in a number of Russell Group institutions.<sup>23</sup> A number of specific examples of innovative efficiency saving schemes are provided in the Russell Group publication *Staying on top: The challenge of sustaining world-class higher education in the UK*.
- 2.35 However, the extent to which efficiency savings can continue to be made without a negative impact on teaching quality or the international standing of the UK's leading universities is highly questionable. Moreover, even whilst efficiency savings should continue to be sought, they alone will not be sufficient to fully meet the urgent resource needs of research-intensive universities.

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<sup>15</sup> The Russell Group, *Submission to the Independent Review of Higher Education Funding and Student Support - first call* (January 2010)

<sup>16</sup> *Education at a Glance 2009: OECD Indicators* (The UK has average graduation rates for Tertiary type A programmes, and rates which are significantly above the OECD average for tertiary type B programmes).

<sup>17</sup> *Education at a Glance* (Ibid): This statistic refers to the UK's completion rates for tertiary type A programmes

<sup>18</sup> *Education at a Glance 2009* (Ibid)

<sup>19</sup> See, for example, Arnaud Chevalier and Gavan Conlon, *Does it pay to go to a prestigious university?* Centre for the Economics of Education, LSE (March 2003); McNally S, Hussain I, Telhaj S, *University Quality and Graduate Wages in the UK* (March 2009); Chevalier, A *Does Higher Education Quality Matter in the UK?* April 2009, Unpublished

<sup>20</sup> Factoring in a 6% higher relative wage premium than those reported for the UK sector in OECD stats for 2007 would give an average relative earnings premium of 23%; third highest among OECD countries.

<sup>21</sup> Figures quoted in *'The Scientific Century: securing our future prosperity'*, Royal Society (March 2010)

<sup>22</sup> Evidence Ltd, *International Benchmarking Study of UK Research Performance 2009*, a report for the Department of Business, Innovation and Skills, September 2009

<sup>23</sup> Information on some of these programmes can be provided on request

### **3. An increase in graduate tuition contributions will be an essential component of any future funding system for universities**

#### **3.0 The best and fairest solution is a combination of public funding, business investment and graduate contributions**

- 3.01 The UK's economy and society derive significant benefits from research-intensive universities. Evidence from a wide range of sources confirmed that research in this country is world-leading and depends on a supply of highly skilled graduates and postgraduates. It generates not only discrete benefits from commercialising innovative new technologies and products, but a host of wider benefits relating to its impact on healthcare, the environment, and on our culture and society. Graduates from higher education are the highly skilled employees, business leaders and entrepreneurs so essential to the UK's economic competitiveness. Moreover, there is strong evidence that graduates are generally active and engaged citizens, contribute to building social capital, and benefit society through their engagement and support for charitable activities. They also tend to be more tolerant than individuals with lower qualifications, are less likely to smoke or become overweight, and less likely to become depressed than non-graduates.<sup>24</sup>
- 3.02 Many of these benefits will be realised by graduates themselves. However, there are clearly spillover benefits to society as a whole which are unlikely to be captured in their entirety by individual graduates or by the businesses which employ them. In addition, to ensure that the economy and society benefits from sustained, long-term investment in curiosity-driven research, it is essential that such research is supported by public funding.<sup>25</sup> It is for these reasons that governments around the world invest in higher education, and why there is a strong case for continued public investment in universities and their students in this country.
- 3.03 Businesses are also important beneficiaries of higher education in the UK. Many rely on the highly skilled graduates which universities produce. They also benefit from university research and its contribution to product innovation, improved business management and productivity. It is therefore reasonable to expect the business community to share part of the cost of supporting a world-leading system of higher education in this country. Although businesses have readily accepted this role (as articulated, for example, in the CBI's report *Stronger Together*), direct support to universities is always likely to be limited (see paragraphs 2.24 – 2.29).
- 3.04 There is a persuasive case that university graduates should be expected to make a contribution to the costs of their own higher education:
- Private return. Although the social benefits of higher education are likely to be substantial, they are difficult to quantify. Conversely, the evidence that higher education generates significant private returns is substantial and robust. The graduate premium for a university degree over at least two A-levels for one's entire working life is between 20-25%.<sup>26</sup> This represents approximately £160,000 in today's terms. As well as receiving higher salaries, graduates also tend to be more satisfied

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<sup>24</sup> Bynner, J. and Egerton, M. *The Wider Benefits of HE*. Report by IoE for the Higher Education Funding Council in England (HEFCE) and the Smith Institute (2001); Bynner, J. *et al. Revisiting the Benefits of HE*. Bedford Group for Lifecourse and Statistical Studies, The Institute of Education (IoE) (2003).

<sup>25</sup> This is discussed further in the report '*The economic impact of research conducted by Russell Group universities*' ([www.russellgroup.ac.uk](http://www.russellgroup.ac.uk))

<sup>26</sup> Universities UK *The economic benefits of a degree* (2007)

with their careers. As discussed in more detail below (paragraph 3.12), the graduate premium for graduates from Russell Group universities is higher than that for the sector as a whole.

- The inequity of a universal subsidy. A higher education system which is funded purely through the public purse requires all taxpayers to fund a share in the costs of higher education regardless of whether they or their families receive a direct share of the benefits. A significant majority of people who currently benefit continue to be those from higher socio-economic groups.<sup>27</sup> Better-off families therefore reap the majority of the benefit from a publicly funded system, without financing the majority of its costs, and therefore the system is regressive.<sup>28</sup>
- It is certainly true that graduates contribute, by virtue of their higher earnings, a higher level of taxes which the Government may in part use to finance higher education. However, the proportion of these taxes which is used to fund higher education is relatively small, and it can be shown that the average graduate funds just 9% of the cost of his or her degree through taxation.<sup>29</sup>

3.05 There is therefore a clear argument that a fair system of funding higher education should involve a balance between public investment, some support from business, and contributions by graduates. The higher education reforms introduced in 2006 recognised the need for this balance. However, the cap on graduate contributions coupled with an over-generous student support system has meant the taxpayer continues to foot the majority of the costs. Graduate contributions should be increased to better reflect the considerable private benefits which graduates gain from higher education.

### **3.1 Variable graduate contributions ensure fairer pricing of higher education.**

3.11 Graduate contributions which can be fixed at different levels by universities introduce the possibility of variable prices, with important benefits for equality and access.

3.12 The current model of Government funding treats all higher education as broadly similar, and accordingly provides a universal level of resource to support teaching. This has two broad consequences:

- I. It fails to recognise that universities operate diverse models of education, and therefore incur different costs, even within the same subject.<sup>30</sup> This introduces the possibility that some institutions will be relatively under-funded, and some relatively over-funded, thus creating inefficiencies. It is inevitably problematic, if not impossible, for central planning to fund this variation efficiently. The ability to vary prices from institution to institution, and from subject to subject, is therefore a necessary solution to the problem of appropriately funding very different higher education provision.

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<sup>27</sup> In 2002 81% of children from professional backgrounds went to university, compared with just 15% of students from manual backgrounds: House of Commons Education and Skills Committee *Post-16 Student Support*. Sixth report of session 2001-02. In 2008/09, two thirds of accepted applicants to higher education came from the top 3 socio-economic groups, and three quarters from the top 4 (UCAS application statistics, reported in HESA).

<sup>28</sup> For a more detailed treatment of these arguments see: Barr, N. *Financing Higher Education in the UK: the 2003 White Paper memorandum to the Education and Skills Committee's inquiry into the White Paper 'The Future of Higher Education'* (2003)

<sup>29</sup> Figure based on average lifetime earnings premium of £160,000, and public expenditure on higher education as a proportion of total public expenditure (calculations can be provided on request).

<sup>30</sup> There may be a separate question over whether the existing system provides sufficient support for higher cost subjects (such as some laboratory subjects). This question is not discussed within this document, but it is one which poses further challenging questions on whether any shortfall would be more appropriately addressed through higher graduate contributions within those subjects, or by modifying how the public teaching grant is allocated.

- II. In a system which provides a flat level of funding across the higher education sector, those who stand to gain most from their degree will benefit from the same level of public support as those who will gain least. There is good evidence to suggest that while graduates as a whole benefit from their degree, there are considerable differences in the benefits secured from different institutions and different subjects, particularly regarding wage premiums. For example:
- i. Research conducted in 2003 showed that there was a 10% wage premium realised by graduates from Russell Group universities compared with graduates from modern universities.<sup>31</sup>
  - ii. A subsequent study by the same authors showed that wage premia existed both for higher quality institutions and subjects, with a wage premium of up to 6% associated with graduating from the highest quality institution/subject combinations compared with subjects and institutions falling within a lower quality band.<sup>32</sup>
  - iii. Research by McNally *et al* has also found that graduates from institutions falling within the highest quartile of RAE scores (in a sample of 38 institutions) could expect a wage premium of between 10-16%.<sup>33</sup>
  - iv. The latest data on graduate destinations shows that these trends are apparent in starting salaries, with Russell Group graduates securing on average a wage premium of £3,000 over graduates from other institutions six months after graduation.<sup>34</sup>
  - v. It is not always easy to disentangle the effect of the university experience itself on wage premia from other effects, such as prior attainment, or institutional reputation. However, there is some evidence (see Box 1), that the impact of university education is independent of these factors.

Box 1: Wage premia associated with research-intensive universities: the case for differential pricing

Some studies on rates of return to graduates control for important aspects of graduate salaries which do not relate to university choice, such as prior attainment levels and socio-economic backgrounds. Chevalier and Conlon note:

*“The quality premium is never correlated with either ability or family background...the wage premium for attending [Russell Group Universities] is independent of the student’s characteristics. Prestigious universities level the playing field within their intake.”*

Studies also show that wage premia are consistent throughout a graduate’s career. HESA’s three year survey of graduate destinations also provides evidence of an enduring salary premium associated with Russell Group universities. It shows that the average wage premium for those graduating from Russell Group universities in 2004/05 had doubled by 2007/08.

Some universities therefore confer advantages on their graduates which result in significant and sustained wage premia, and which appear to be independent of prior attainment or reputational effects.

<sup>31</sup> This statistic comes from an OLS linear estimation technique, which controls for individual characteristics including A-level scores, parental background, the school the individual attended among other factors affecting wages. Chevalier, A. and Conlon, G. *Does it pay to go to a prestigious university?* Centre for the Economics of Education, LSE (March 2003) – table 5 for the 1995 cohort, page 29.

<sup>32</sup> Chevalier, A *Does Higher Education Quality Matter in the UK?* Royal Holloway, University of London. Mimeo (April 2009)

<sup>33</sup> McNally S, Hussain I, Telhaj S, *University Quality and Graduate Wages in the U.K.* March 2009

<sup>34</sup> HESA Destinations of Leavers survey 2007/08: Average salary of full-time, first degree leavers entering full-time paid employment by institution 2007/08

- 3.13 It is important to note that this variation extends far beyond simply a difference in the wages they receive as graduates, and incorporates the entirety of the educational experience they receive while studying, as well as less clear-cut benefits in their future careers, such as job satisfaction. This package of benefits, not all of which should be expected to translate into direct financial advantages, is an important justification for fixing graduate contributions according to institution or subject, rather than simply tying them to future earnings.

### **3.2. Increased graduate contributions should be additional to public funding.**

- 3.21 The role of public funding alongside graduate contributions should be reassessed. Section 3.0 outlines the strong case for continued public investment in higher education. It is made in recognition of the substantial benefits accorded to our society by graduates, which can never be captured in their entirety by graduates themselves. While this paper makes the argument for a greater share of costs to be met by private individuals, there remains a strong need for continued public investment to support the wider benefits which higher education confers upon society. It is therefore crucial that any increase in graduate contributions should be additional to maintaining current levels of public investment.
- 3.22 However, the current system for allocating public funding to universities for teaching should be modified – not least because STEM subjects like Chemistry and Physics are under-funded. The level of public funding for a higher education student should be a factor of the cost of providing the course, the private return, and the public return, so that the costs of the course are not wholly passed on to the student. This system has been developed in Australia, where public funding covers a large proportion of the costs of high-cost subjects deemed to be of strategic importance, such as medicine, science and mathematics. At the same time, subjects which are deemed to be of lower strategic importance, such as Law, receive very little public subsidy, and a much greater proportion of costs are covered by graduate contributions. Introducing a system of this nature in England would ensure that institutions will not have to increase significantly the fees for high-cost subjects like Chemistry, Physics and Engineering, and that the public subsidy for teaching is better targeted towards areas where subsidies can achieve the greatest public benefit.

### **3.3. Some regulation of graduate contributions should remain but liberalisation of the fee regime should be a future aim**

- 3.31 The most effective way of protecting quality while ensuring long-term sustainability would be to allow institutions to determine the level of all fees for all undergraduates and not just postgraduates, part-time and international students; but we recognise that it is likely to be more appropriate to have an incremental approach to removing the fee cap, allowing time for key requirements of a successful liberalised system to develop.

### **3.4. Students would be provided with even better information**

- 3.41 Access to better information on the student support system, the very low risk associated with income-contingent loans, and the additional financial support which may be available to students must be a cornerstone of the future development of the student support system. Student perceptions of financing higher education are key, and we suggest that it would be helpful for the current terminology of tuition 'fees' and 'loans' to be replaced with the more accurate language of 'graduate contributions'.

- 3.42 In tandem, a system of differential pricing between universities and higher graduate contributions should be underpinned by clear, transparent and meaningful information for students on degree quality, student experience and the likely rate of return from different degrees. However, it is important to consider carefully how student requirements for more and clearer information about their university experience can be addressed most effectively and appropriately. There is a large amount of existing information pertaining to the quality of university education and the return graduates can expect from their degree, much of which is already in the public domain,<sup>35</sup> but Russell Group institutions are happy to continue to seek ways of providing better and clearer information in a structured manner that meets students' requirements. It will be important to avoid simplistic 'traffic light' indicators for higher education which could be very misleading. The concept of more detailed 'quality profiles' which would provide multi-dimensional indicators covering all of universities' core activities merits further consideration.<sup>36</sup>
- 3.43 The following paragraphs list some aspects of the student experience where Russell Group universities are aiming to provide additional information:

*Information useful for potential students:*

- I. Graduate salaries: An indication of the rate of return which graduates secure can be an important factor in helping prospective students assess the level of private benefit they can expect to receive from their education.
- II. 'Employability': In addition to data on salaries, further parameters, such as job satisfaction, overall level of employment and employment in 'graduate-level' jobs, could also be used to create composite information on graduate 'employability'. Additional courses or opportunities offered to enhance students' employability, such as internship opportunities, could also be included in this indicator.
- III. Progression to postgraduate study: This would give students an indication of the likelihood of progressing from a particular undergraduate degree to postgraduate study. Postgraduate study is known to confer significant benefits on graduates.
- IV. Retention rate: The student retention rate can serve as a useful marker for the level of help and support which universities can provide their students.
- V. RAE/REF quality profile: Teaching and learning within higher education is inextricably linked to research, as is demonstrated in the Russell Group paper on the research-led learning experience.<sup>37</sup> The learning experience which students receive therefore draws heavily upon the quality of an institution's research, making research performance a useful indicator for students.
- VI. Facilities: A key factor in providing a leading student experience is the quality of facilities, both educational and domestic, available to students. These include library facilities, laboratories, accommodation, sporting facilities, and other relevant services which students will benefit from during their time at university.

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<sup>35</sup> For example, a lot of information is available on Unistats and UCAS websites.

<sup>36</sup> For example: Brink, C. *On Quality and Standards*. Keynote Address at the Australian Universities Quality Forum, Alice Springs (1-3 July 2009)

<sup>37</sup> The Russell Group of Universities, *Research-led learning, the Heart of a Russell Group Learning Experience* ([www.russellgroup.ac.uk](http://www.russellgroup.ac.uk))



- VII. Bursaries and other financial support: Bursaries, and other forms of financial support and advice, are an important tool in attracting applicants from low-participation backgrounds into selective universities.<sup>38</sup> The availability of this support should be made clearly available to prospective applicants.

#### *Useful for the Government*

- VIII. Access initiatives: The extent of an institution's programmes to promote access to higher education could be a useful measure of its commitment to widening participation. However, existing outcomes measures such as the number of students from under-represented groups recruited by an institution should be used with caution, since they are unable to fully capture the benefits of many universities' access initiatives which help widen participation to higher education more broadly.

3.44 It has also been suggested that more information on the following aspects of different degrees might be useful to potential students. However, the relationship between these factors and teaching quality is complex, and therefore, these need to be treated with a greater degree of caution.

- IX. Staff-student ratio: The staff-student ratio (SSR) has been used in published literature in making an assessment of the overall quality of the student experience. However, its relationship to the quality of teaching, and the student experience is not a direct one.

- X. Contact hours: The level and quality of contact which students have with academic staff has frequently been cited as a proxy for assessing teaching quality.<sup>39</sup> However, the relationship between contact and teaching quality is far from straight-forward, and it is important that any additional information is presented in the most meaningful manner possible. Contact hours necessarily vary significantly between different academic subjects. In consequence, it would be most helpful if information on contact were presented in narrative form, rather than quantitative figures, allowing universities to explain more fully some of the complexities involved.

3.45 Although some of the factors highlighted can be useful in helping students to understand the kind of student experience they can expect, they can all be subject to a degree of subjective interpretation. Russell Group universities provide an outstanding education and overall university experience for their students, and welcome the chance to demonstrate this to prospective applicants. In order to do so, it is important that information which is open to different interpretations can be presented in a manner which highlights that inherent subjectivity. A forthcoming Russell Group paper will go into greater detail on providing better information to students in the most helpful format.

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<sup>38</sup> Claire Callender, *Awareness, take-up and impact of institutional bursaries and scholarships in England*, A report to the Office for Fair Access (November 2009)

<sup>39</sup> See, for example, HEPI reports: *The Academic Experience of Students in English Universities* (2006, 2007 and 2009)

### **3.5. Graduate contributions mean that students tend to value their education more highly and get more from their university experience**

- 3.51 Evidence shows that when people are asked to contribute even a nominal amount towards the cost of a service, they tend to value that service more highly, be more careful about the choices they make, and show greater commitment to those choices.<sup>40</sup> People also often do not act strictly 'rationally' (in economic terms) when faced with a zero price.<sup>41</sup>
- 3.52 This is not to say that students and graduates need to pay towards the cost of higher education in order to attach value to the benefits they derive from it. However, having made a clear financial contribution, students can become more empowered participants. They are likely to become more demanding, seeking to have more input into, but also receive more from, their education and student experience. As former Higher Education Minister David Lammy has stated: *"Since the introduction of variable fees in 2005 especially, students have gradually become much less passive consumers of what their universities dish out...they're much more concerned than ever before about what the return on the education they're helping to pay for will be."*<sup>42</sup>
- 3.53 There is already some early evidence to suggest students have indeed become more demanding and expect a higher quality student experience since the introduction of graduate contributions. Evidence from the Higher Education Academy shows that students tend to expect a higher overall quality of service, including facilities such as IT and libraries, and to expect more comprehensive access to these services.<sup>43</sup>

### **3.6. Graduate contributions supported by income-contingent loans have proved to be supportive of fair and widening access**

- 3.61 Two key objections are often made to increasing graduate contributions. The first is the potential impact on access. The second is the impact on the costs of student support. Our previous submission to the Review showed that graduate contributions, if supported by income-contingent loans, need not be a barrier to accessing higher education. On the contrary, such a system can support *improved* access by under-represented groups, including those from lower socio-economic groups.
- 3.62 The submission demonstrated the strong evidence that:
- The introduction of variable fees in the UK has been accompanied by improvements in access
  - International experience shows that fees coupled with income-contingent repayments protect access
  - The barriers to access lie in underachievement at school; lack of good information, advice and guidance not least about the real costs and benefits of going to university; risk aversion and lack of confidence

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<sup>40</sup> See, for example, Alison Wolf, *How to shift power to learners: Encouraging FE dynamism, replacing centralised procurement*. Centre for Innovation in Learning (2010): pp 29 and references therein.

<sup>41</sup> Shampanier, Mazar, and Ariely, D. (2007) "Zero as a Special Price: The True Value of Free Products", *Marketing Science*, 26(6), pp. 742–757.

<sup>42</sup> David Lammy MP, *Speech to Graduate Employability Conference*. Queen Elizabeth II Conference Centre, London (3 March 2010)

<sup>43</sup> Paul Ramsden, 2008. *The Future of Higher Education: Teaching and the Student Experience*. (Available from [http://www.dius.gov.uk/higher\\_education/shape\\_and\\_structure/he\\_debate/-/media/publications/T/teaching\\_and\\_student\\_experience\\_131008](http://www.dius.gov.uk/higher_education/shape_and_structure/he_debate/-/media/publications/T/teaching_and_student_experience_131008))

- Fee income to universities can help address these barriers by providing resources for university outreach activities and institutional bursaries

3.63 Additional income from tuition fees has provided universities with increased resources to develop outreach activities, access courses and other targeted initiatives to help increase participation at Russell Group institutions by students from under-represented groups. It has also helped support work with schools and colleges aimed at increasing awareness of higher education and its benefits, and at raising aspirations and attainment. Russell Group universities also provide generous financial support through bursaries for students from low-income backgrounds. In 2007/08, they devoted 26% of their additional fee income, on average, towards bursaries, scholarships and widening participation initiatives.<sup>44</sup> Any increase in graduate contributions would therefore provide further resources for Russell Group universities to use in ensuring fair access for all students with the greatest potential.

3.64 The role of institutional bursaries in supporting participation and fair access to highly-selective universities is complex. With a system of student support based on no up-front payments and income-contingent repayment, as in England, financial considerations should not be a barrier to participation. However, we do know that bursaries are a factor in deciding which university to apply to and they can help overcome some of the concerns and misconceptions some students have about Russell Group universities. Moreover, in moving towards an environment of greater variability in graduate contributions between institutions and courses, institutional bursaries are likely to have an important role to play in protecting fair access to the most selective institutions, and to the courses and institutions demanding higher graduate contributions. Annex A discusses in more detail the role of bursaries in promoting fair access.

### **3.7 Higher graduate contributions can be affordable for the Government if the student support system is improved**

3.71 Recent research by the IFS shows that, although the 2006 student finance reforms resulted in increased contributions from graduates, they also resulted in increased costs to the taxpayer.<sup>45</sup> The reforms were designed to increase funding for universities and to reflect the substantial private benefits which graduates gain from their education, by asking them to bear a greater share of its costs. However, since 2006 the Government has seen a net increase in its costs for student support, and the balance of cost between the taxpayer and graduates has not changed significantly.

3.72 The student support system therefore needs to be reformed to limit its prohibitive cost to the taxpayer. The Russell Group's previous submission to the Review showed that the system could be made more equitable and at the same time more affordable to the Government through:

- I. The introduction of a real rate of interest
- II. An increase in repayment rates

3.73 A revised student support system should also incorporate mechanisms to encourage up-front payments, thereby reducing the overall burden of debt on the public purse. The simple step of introducing a real rate of interest should encourage some up-front

<sup>44</sup> OFFA, *Access agreement monitoring: outcomes for 2007/08*, March 2009

<sup>45</sup> The Institute for Fiscal Studies, *The Impact of the 2006-07 package of reforms to HE funding*; Submission to the 2010 Fees Review, 19<sup>th</sup> January 2010

payments (within the present system, it is not economically 'rational' to seek to pay loans off early). In Australia, rather than a real interest rate, a surcharge is added to the loan to reflect the Government's costs of borrowing, and students who pay upfront are not required to pay the surcharge.

- 3.74 Early repayment could also be encouraged by simple administrative measures that would facilitate loan repayments by third parties, such as the families of students and graduates. One such measure could be to allow loan repayments to be made by direct debit. Measures of this nature could also help to encourage investment from the private sector, allowing businesses to make monthly repayments to the Student Loans Company on behalf of graduate employees, while at the same time providing employees with an additional incentive to commit to the company. Employers may of course argue that these contributions are already paid in effect through higher graduate salaries, but making a more explicit contribution towards the cost of higher education in this way may be attractive for some businesses.
- 3.75 Reducing the overall costs of public lending through the mechanisms outlined above, and redirecting the savings to allow for larger student loans would facilitate higher graduate contributions, whilst ensuring that loans would continue to be available to cover any price increases.
- 3.76 Initial modelling suggests that making a number of reforms to the current student support system could reduce the overall costs of providing student loans for Government, even if graduate contributions were increased. Government could achieve an overall cost reduction in comparison to the current system, whilst still providing loans to cover the full tuition fee, even up to a fee of £9,000 per year, if necessary.<sup>46</sup> Subsidies would be targeted towards the lowest earning graduates, while overall increases in monthly payments for other graduates would be moderate. The Review will be aware that comprehensive modelling by the Institute of Fiscal studies reached similar conclusions.

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<sup>46</sup> Calculations can be provided on request

<p align="center"><b>A student support system capable of supporting increased graduate contributions</b></p> <p align="center">How it addresses the key questions asked by the Review</p>		
<p>1) <i>Ensure sustainability for higher education as a whole</i></p>	<p align="center">✓✓✓</p>	<ul style="list-style-type: none"> <li>• <i>Could help to provide sufficient funding to sustain a cadre of world-leading higher education institutions</i></li> <li>• <i>Would ensure that long-run costs to the taxpayer did not increase or were reduced, but does require increased public borrowing</i></li> <li>• <i>Encouraging upfront payments would reduce debt burden and provide for employer support; it would also accelerate repayment to the government</i></li> </ul>
<p>2) <i>Mechanisms to drive up quality and efficiency in higher education</i></p>	<p align="center">✓✓✓✓</p>	<ul style="list-style-type: none"> <li>• <i>Facilitates variable pricing and will provide both an additional incentive and additional resource for universities to invest in a high quality student experience</i></li> <li>• <i>Variable pricing will allow diverse modes of higher education to be funded efficiently and sufficiently</i></li> <li>• <i>Encourages students to be more demanding of a high quality student experience</i></li> <li>• <i>Provides resources to invest in teaching and learning and the student experience</i></li> </ul>
<p>3) <i>Incentivising participation</i></p>	<p align="center">✓✓✓</p>	<ul style="list-style-type: none"> <li>• <i>Retains zero upfront charges for students</i></li> <li>• <i>Overall increase in costs to graduates, but repayments still linked to income, so affordable</i></li> </ul>
<p>4) <i>Promoting fair access</i></p>	<p align="center">✓✓✓</p>	<ul style="list-style-type: none"> <li>• <i>Additional income for universities to encourage fair access through bursaries and widening participation initiatives</i></li> </ul>

#### **4. If the public purse cannot support further lending, alternative sources of investment should be considered**

- 4.01 Improving the student support system would reduce long-run costs to Government, but this does not address the fact that higher graduate contributions would entail greater year-on-year spending. In a difficult financial climate, a significant increase in short-term expenditure may not be feasible for the Government.
- 4.02 If this proves to be the case, the private sector could provide some of the up-front capital to support higher graduate contributions. Private lending to students is already common practice in other countries such as the US. In the UK, Career Development Loans are an established model through which individuals borrow from private lenders to cover the costs of undertaking training and education, and of course international students routinely do so.
- 4.03 The sections which follow outline a number of options which could facilitate higher graduate contributions, with a student support system in part or in whole financed by the private sector. It has not yet been possible to undertake a detailed options appraisal, nor to obtain detailed financial advice on the exact manner in which the proposed models might function. For these reasons, this submission does not attempt to define the parameters of a given system in detail, and although it highlights some obvious strengths and weaknesses, there is no attempt to undertake calculations of costs to various stakeholders.
- 4.04 For graduate contributions to be successfully supported by private lenders, two key conditions must be met. First, investors will seek some guarantee that their capital investment will be secure. The greater the strength of this guarantee, the lower the premium investors will seek, as interest paid on their original investment. Hence if Government guarantees the investment, then the premium investors expect would be low, matching the interest premium paid on government-issued bonds. For less secure investments, investors would expect a higher premium, to compensate for the risk they would be taking. For the options outlined below, a basic indication of the security of the investment and probable risk premium has been provided by giving a 'score' from 1 – 4, where 1 is low risk, and 4 is high risk.
- 4.05 The second key requirement is that the loans can operate on a zero-profit basis (i.e. they cannot be loss-making for investors). Since some graduates within an income-contingent system will not repay the full value of their loan, an additional risk-premium may need to be charged to ensure that repayments across the cohort as a whole are equal to the value of the initial investment. The overall risk premium which will have to be met by graduate repayments will therefore be a factor of the perceived investment risk, and the premium needed to adjust for under-repayment by some graduates.
- 4.06 The manner in which this impacts on graduate repayments will depend upon the particular model of finance concerned. Where fixed loans are made to students, an interest premium will have to be charged on graduate repayments which is sufficient to ensure that the cohort as a whole will repay the full value of the loans. Where universities seek to capitalise deferred payments set at a fixed level, then the level of interest premium charged on repayments will impact on the amount of up-front investment which can be secured from private investors through this capitalisation (and therefore the level of funding available to universities to invest in their students' education).
- 4.07 It is important to note that not all the models proposed will be appropriate for all institutions, so that it may be unhelpful to focus on one particular option as a universal

solution. Nevertheless, initial research suggests that all the models outlined represent viable options.

#### **4.1. Admissions processes must remain fair to all and strategically important subjects should be protected**

- 4.11 In some of the options proposed below the university, rather than the state, would carry some of the financial risk for the costs of loans or grants to its students. This is not unreasonable, given the additional resources which these options would generate for universities.
- 4.12 In such a system, however, it is vital that access is protected so that all those who are capable and who wish to benefit from higher education can do so. Universities will therefore need to maintain an unequivocal commitment to 'needs-blind admissions'; i.e. to admit students based on their qualifications and potential, without any consideration of the likely costs to the institution of a student's entitlement to loans or bursaries. Equally, universities will need to retain their commitment to providing a leading education not only in academic subjects where individuals stand to realise the greatest benefit from their degree, but in those subjects which may be less lucrative to the individual, but of key strategic importance to the UK.
- 4.13 Universities in the UK have a strong track record of providing the highest quality education, with due regard for the wider interests of the economy and society. As charities, they already carry out their duty to ensure that the benefits they provide are not 'unreasonably restricted...by ability to pay'.<sup>47</sup> They are also very used to managing the overall sustainability of their teaching provision, rather than simply expanding the most profitable courses. However, if there were incentives which threatened to put at risk the health of strategically important subjects, or to create a barrier to participation by certain groups of students, then there may be a role for Government intervention. There are a range of mechanisms which Government could deploy if this was deemed necessary. One example is the funding model used by Australian Government (described in paragraph 3.22)

#### **4.2 Traditional bank loans are not ideal for students**

- 4.21 Traditionally, banks lend to individuals on a fixed term, rather than an income-contingent basis. This kind of loan is clearly more risky for students than income-contingent loans, since if they fail to earn sufficient money as graduates, they may find it difficult to meet the fixed monthly repayments. Moreover, banks determine the conditions of a loan, in particular the interest rate, through an assessment of risk based largely on the collateral which can be set against the loan. Students in general have little to offer by way of collateral, but the students offered more favourable deals are likely to be those from higher-income backgrounds, whose families may be able to stand guarantor against the graduate being unable to meet their repayments. Expecting students to rely on loans of this nature would therefore lead to inefficiently low levels of borrowing, and would tend to limit access to higher education.
- 4.22 There are mechanisms to attenuate these factors, by placing a greater emphasis on the role of parental contributions and up-front assessment of ability to pay. In a system of this nature, public loans could be provided up to the full cost of students' tuition on an

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<sup>47</sup> The Charity Commission, *Charities and public benefit: The Charity Commission's General Guidance on Public Benefit* (January 2008)

income-assessed basis. Loan entitlements would be staggered in accordance with assessed family income, in a similar fashion to assessing maintenance grant entitlement under the current system. Students from the highest-income families, who might be expected to pay for tuition upfront, or whose families could provide the collateral to secure generous repayment conditions, would be expected to cover the entire cost of their tuition through private loans. A system combining these elements was recently proposed by the think tank Policy Exchange.<sup>48</sup>

- 4.23 However, a mixed system of this nature would challenge the principle of a higher education sector which is accessible to all, regardless of financial need. Because some students would not be offered the opportunity to defer their fee, other than through a potentially risky bank loan, individuals could be excluded from accessing higher education on the basis of ability to pay. For this reason, subsequent sections in this submission provide options for all students to defer payment. They focus on mechanisms for *income-contingent* loans funded by private lenders.

### **4.3 Privately funded income-contingent loans are a feasible option and should be explored further**

- 4.31 Rather than resorting to an entirely private lending market, it should be possible to leverage private investment on the basis of income-linked repayments to which students commit within a regulated support system. There are three basic models, or levels, at which this can be achieved:
- I. At the national level (up-front or retrospective sale of the student loan book): this would involve a similar system to the current one, but the Student Loans Company would finance lending to students by either retrospective sales of existing debt, or up-front sales of bonds linked to graduate repayments.
  - II. At institutional level (investment in a cohort of graduates from a particular institution or group of institutions): in this model, individual universities or a group of universities could secure up-front funding from private investors on the strength of the future contributions of their graduates.
  - III. At the individual level (income-contingent private loans to individual students): in this model, individual students would be able to obtain an income-contingent loan from a bank, to fund increased tuition contributions.

### **4.4 Sale of national student debt**

- 4.41 One of the most straightforward ways to leverage capital investment in student loans is to sell student debt on the capital markets. In such cases the debt remains under the administration of the SLC and, because of the subsidies within the student support system, the debt will generally be bought for a fraction of its nominal value. One benefit of reducing the subsidies within the current system is that it will reduce the net loss which the taxpayer would be required to underwrite on any further sales of debt.
- 4.42 An alternative mechanism is to secure up-front finance from private investors. In this case, the Student Loans Company would effectively finance its lending to students through the sale of bonds to private investors. Such a system has been established in Hungary, where a private company (the student loans centre) administers loans and

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<sup>48</sup> Anna Fazackerly and Julian Chant, *More Fees Please? The future of university fees for undergraduate students*; Policy Exchange, February 2010



finances its lending through the sale of student debt bonds to investors.<sup>49</sup> There is therefore no up-front burden on the public purse, but lending remains income-contingent.

- 4.43 In the Hungarian system, there is additional protection for low earning graduates in the form of debt write-off. The Government underwrites student bonds, guaranteeing buyers a return on their investment. Consequently, as the bonds do not transfer the risk associated with the debt package onto investors, the Government still incurs a substantial liability on behalf of the student loans centre. An alternative to the full Government guarantee would be for the Government to partially underwrite, i.e. to offer some underwriting of the debt without it having to appear on the Government's 'books'. The UK Government adopted a similar approach to the issuance of Network Rail Bonds in 2004, where debt was underwritten by a financial indemnity from the Strategic Rail Authority, and a supporting letter from the Secretary of State for Transport. This resulted in AAA rated bonds, allowing Network Rail to borrow at similar rates to the Government, but the debt did not appear on government books<sup>50</sup>. This approach would create a more attractive investment than securitised student debt alone, helping universities to secure more of the true economic value of student contributions through the sale of bonds, while limiting the Government's liability.

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<sup>49</sup> For a comprehensive overview of the system, see Edina Berlinger, *An efficient student loan system: case study of Hungary*; Higher Education in Europe, v34 n2 p257-267 Jul 2009

<sup>50</sup> The Office of Rail Regulation was also able to limit the company's total borrowing. The Government was able to keep Network Rail debt off the Government books because, according to a spokesperson from the then Department for Transport, the liabilities were contingent and unlikely ever to be called upon. (See Times article, "*Network Rail to issue £20bn bonds over five years*"; November 2 2004: [http://business.timesonline.co.uk/tol/business/industry\\_sectors/transport/article501851.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/transport/article501851.ece))

<b>Upfront sale of student debt by SLC</b>		
How it addresses the key questions asked by the Review		
<i>1) Ensure sustainability for higher education as a whole</i>	✓✓✓✓	<ul style="list-style-type: none"> <li>• <i>Could provide additional funding for universities through increased graduate contributions</i></li> <li>• <i>Depending on risk sharing, could greatly reduce long-run costs of student support to the taxpayer</i></li> <li>• <i>Limits or even eliminates public borrowing to finance student loans</i></li> <li>• <i>Caveat: an additional risk premium would need to be charged to cover the cost of debt write-off by lower-earning graduates. This would mean graduates paying a higher interest rate than the Government's cost of borrowing. Would need to ensure this does not act as a disincentive to students.</i></li> </ul> <p style="text-align: right;">(Risk level: 1)</p>
<i>2) Mechanisms to drive up quality and efficiency in higher education</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Coupled with increased graduate contributions, would facilitate variable pricing and encourages students to be more demanding.</i></li> </ul>
<i>3) Incentivising participation</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Reduced burden on public purse could allow increased student numbers (although we believe that improving quality is a greater priority than expanding numbers)</i></li> <li>• <i>More affordable to extend student support beyond full time undergraduates</i></li> </ul>
<i>4) Promoting fair access</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Additional income for universities to encourage fair access through bursaries and widening participation initiatives</i></li> </ul>

#### **4.5. Graduate income-linked bonds based on a university or group of universities**

- 4.51 As an alternative to a national system, universities themselves could be allowed to leverage the future salaries of their graduates to obtain up-front investment on the capital markets.
- 4.52 The basis of this model is that, in the absence of public loans to support all graduate contributions, the public loan would be capped at a certain level, but with universities permitted to charge additional fees above the level of the public loan cap, to be paid

directly to the university.<sup>51</sup> Since there would be no public loan to cover the additional fee, universities would receive them either as up-front payment from students, which the system could be designed to encourage, or as a deferred payment, which would be payable alongside the repayments due on the public loan.

- 4.53 Universities would then generate additional up-front investment by leveraging the future contributions of their graduates to secure funding from private investors. This could either be through issuing bonds directly linked to the income stream received from graduate repayments, or through the university itself selling annuities, which it would fund through income from graduate repayments.

#### Bonds directly linked to graduate repayments

- 4.54 In this model there is an explicit link between graduate contributions and private borrowing. In a variant of the student debt bonds described above, universities would sell 'Graduate income-linked bonds' to raise money from capital markets.<sup>52</sup> Such a proposal would raise up-front cash for universities without placing additional pressure on Government finances. However, a key difference compared to the sale of national student debt bonds would be that bonds would be sold by individual universities or groups of universities, rather than the Government or a national agency. They could therefore be marketed as being linked to a specific institution, or group of institutions, and their graduates. This confers some distinct advantages:

- I. *More generous terms of investment:* Investors may be more confident about investing in graduates from certain institutions, and therefore allow those universities to borrow on better terms than the Student Loans Company. Selling bonds linked to groups of institutions, with a number of cohorts of graduates rolled together, would allow a relatively large bond issue, capable of attracting major investors.
- II. *More competition:* The level of borrowing and the borrowing terms which each institution could secure would vary according to the market's assessment of the quality and future employment prospects of their graduates. This would provide an additional marker of institutional quality for prospective graduates. It would also reduce the incentive for institutions to charge higher prices if they were less able to borrow against future graduate contributions, thus creating further differentiation on price and stronger links between price and quality.
- III. *Link to alumni:* Because bonds would be linked to a cohort of students from a particular institution, they could be effectively marketed to alumni, who might be encouraged to buy bonds at lower than market rates, on the basis that they would be investing to support their own institution and its graduates.

- 4.55 It is important to recognise that borrowing against future graduate contributions in this way poses similar questions on risk management to those outlined in the previous section. With no state guarantee, the risks associated with low repayments by graduates would be borne entirely by investors, who would therefore offer universities a bond price which would be somewhat less than the nominal value of graduate repayments. Again, a partial state guarantee of the sort discussed in paragraph 4.43 would mean that the Government would share some of the risk, without incurring full liability, while universities would be able to secure a more attractive price on the bond issue. It is equally important

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<sup>51</sup> The principle of these university-owned fees is discussed in detail by Professor Neil Shephard: Shephard, N. *Deferred fees for universities*. Oxford-Man Institute, University of Oxford (10 May 2010)

<sup>52</sup> A system of this nature has been proposed by Derek Pretty at the University of Bristol, on the suggestion of a University of Bristol alumnus.

to note the attractiveness of a long-term index-linked income stream to major investors, such as pension funds. It is therefore likely that there would be considerable commercial interest in such a bond.

### Selling university annuities

- 4.56 One disadvantage of the graduate income-linked bond is that private investors would have little information about the graduates who would be making repayments. They might therefore regard this securitised debt as a risky investment and demand a high risk premium. This would be reflected in higher interest rates on graduate repayments, and/or the university would secure a relatively small proportion of the nominal value of graduate repayments as up-front investment (though this would be counterbalanced to some extent by the factors discussed in paragraph 4.55).
- 4.57 An alternative would be for universities themselves to sell an annuity, or a guaranteed income stream, which they would finance through the future contributions they expect to receive from graduates.<sup>53</sup> This would again represent an extremely attractive investment proposition, and would likely incur a much smaller risk premium than selling securitised income from graduates, since it would be linked directly to a University's own cost of borrowing. Universities with a AAA credit rating could borrow at similar cost to the Government.
- 4.58 In this system, by contrast with an instrument linked directly to graduate income, universities would bear the risk of repayments being lower than the income stream they have sold. The extent to which universities could bear this risk is likely to vary considerably, meaning that some would wish to sell a more conservative estimate of future income streams than others. The principle of universities sharing risk in this manner has some attractive features, for example in providing an additional incentive for universities to invest in providing a high quality student experience which will prepare their graduates for the employment market.
- 4.59 The major difficulty with this proposal is that it relies strongly on the current financial position of universities. While credit ratings may relate to some extent to the perceived quality and employability of an institution's graduates, they are more heavily influenced by an institution's current borrowing level and repayment record. This is therefore an option which is unlikely to be attractive or even possible for all institutions.

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<sup>53</sup> The review will be aware that a model of this nature has been proposed by Neil Shephard as a preferred model for universities to bring forward deferred capital payments: Shephard, N. *Deferred fees for universities*. Oxford-Man Institute, University of Oxford (10 May 2010)

## Comparing graduate income-linked bonds with university annuities

<b><i>Graduate income-linked bond</i></b>	
<b>'Pros'</b>	<b>'Cons'</b>
<ul style="list-style-type: none"> <li>• Less risk to universities than selling own annuity</li> <li>• Bond prices linked to perceived employability/earnings potential of graduates</li> <li>• Attracts investment from alumni</li> </ul>	<ul style="list-style-type: none"> <li>• May be seen as 'risky' investments – potentially resulting in high risk premiums/low list price on bonds</li> <li>• Cost of borrowing passed onto graduates (i.e. high risk premium means a lower proportion of the nominal value of graduates' future repayments will be available for universities to invest in their students)</li> </ul>
<b><i>University annuity</i></b>	
<b>'Pros'</b>	<b>'Cons'</b>
<ul style="list-style-type: none"> <li>• Smaller risk premiums likely than graduate income-linked bonds, therefore more money for universities to invest in their students</li> <li>• Universities have a direct financial interest in the future success of their graduates, so an additional incentive to invest in careers services etc.</li> </ul>	<ul style="list-style-type: none"> <li>• Universities bear all the risk if graduate repayments lower than expected. Some institutions might therefore sell very conservative estimates of future revenue from graduates</li> <li>• Cost of borrowing and ability to borrow in this manner depends on institutions' current level of borrowing and financial security; unlikely to be feasible for all HEIs.</li> </ul>

<b>Capitalising graduate repayments through selling bonds or annuities</b>		
How it addresses the key questions asked by the Review		
1) <i>Ensure sustainability for higher education as a whole</i>	✓✓✓✓	<ul style="list-style-type: none"> <li>• <i>Provides additional funding for universities through increased graduate contributions</i></li> <li>• <i>Coupled with an improved student support system, would reduce long-run costs to the taxpayer</i></li> <li>• <i>Limits public borrowing to finance student loans</i></li> </ul> <p><u><i>Bonds linked directly to graduate contributions (Risk level: 2.5)</i></u></p> <ul style="list-style-type: none"> <li>• <i>Institutions could market the bonds to alumni, who may be willing to accept lower risk premiums than the market level</i></li> </ul> <p><u><i>Annuities linked to universities themselves: (Risk level: 2)</i></u></p> <ul style="list-style-type: none"> <li>• <i>Institutions could borrow at lower rates and offer graduates lower interest rates (But may not be possible for all institutions).</i></li> <li>• <i>Universities bear some of the risk of graduates defaulting on their loans</i></li> </ul>
2) <i>Mechanisms to drive up quality and efficiency in higher education</i>	✓✓✓✓	<ul style="list-style-type: none"> <li>• <i>Coupled with increased graduate contributions, facilitates variable pricing and encourages students to be more demanding.</i></li> </ul> <p><u><i>Bonds linked directly to graduate contributions:</i></u></p> <ul style="list-style-type: none"> <li>• <i>Risk premiums on graduate bonds are linked to perceived quality and employability of graduates, giving universities an additional incentive to invest in the best possible education for students.</i></li> </ul> <p><u><i>Annuities linked to universities themselves:</i></u></p> <ul style="list-style-type: none"> <li>• <i>Universities bear the risk of graduate repayments being lower than anticipated, giving them an additional incentive to invest in the best possible education for students.</i></li> </ul>
3) <i>Incentivising participation</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Reduced burden on public purse could allow increased student numbers (although we believe that improving quality is a greater priority than expanding numbers)</i></li> <li>• <i>More affordable to extend student support beyond full time undergraduates</i></li> </ul>
4) <i>Promoting fair access</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Provides additional income for universities to encourage fair access through bursaries and outreach</i></li> </ul>

## 4.6 Individual privately-funded loans, on an income-contingent basis

- 4.61 A final option is to establish a system of *individual* private loans available to students to 'top up' the existing public loan. If both public and private elements of the loan were repaid on an income-contingent, rather than a mortgage-style basis, students would still take on a much lower risk than borrowing privately through a more traditional mortgage-style loan. Preliminary discussions with some commercial banks have indicated that such a system might be feasible.<sup>54</sup>
- 4.62 Again, the management of risk is important. To secure loans on an income-contingent basis, universities or students would be required to offer some collateral. One mechanism for doing this would be for universities to top-slice some of the additional income they receive from the higher loans to provide an insurance 'pool'.
- 4.63 Nevertheless, a system of this nature would also allow universities to secure additional investment without additional pressure on public finances, and without imposing risks on students which would be inimical to widening participation and fair access. In a model proposed by Richard Brown, it is suggested that banks might be able to lend to students at interest rates similar to those offered on mortgages.<sup>55</sup>
- 4.64 Again, loans could be brokered at a national level by a single provider, such as the Student Loans Company. Alternatively, individual institutions could broker loans on behalf of their students.<sup>56</sup> Universities would borrow from the bank to the value of additional fees from a cohort of students, on the understanding that, on graduating, the debt would be transferred from the university to individual graduates. Graduates would therefore gain from a universally accessible loan, with low interest rates prior to graduation, linked to the university's own cost of borrowing. The partner bank would benefit from a large number of new customers every year, to whom it could market additional products and services.
- 4.65 A further variant of this model would be to combine it with a system of income assessed public loans as described previously. All students would therefore be offered the opportunity to defer payment, but students from lower-income backgrounds would benefit from access to government financed loans, with relatively more generous repayment conditions. We are also considering options whereby students accessing privately-funded income-contingent loans might be afforded the option of a loan with more generous repayment conditions, in return for providing a parental guarantee against the possibility of default or underpayment.
- 4.66 This model would also introduce greater market variation, whereby institutions with demonstrable success in producing highly valued and highly employable graduates

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<sup>54</sup> Brown, Richard, *Invest for Greatness in Higher Education*, Institute of Education, October 2009

<sup>55</sup> Currently the average interest rate for a 2-year fixed mortgage is 4.99%: average rate reported by Moneyfacts (a financial publisher) on 23<sup>rd</sup> November 2009 (<http://www.moneyfacts.co.uk/Article/27020/rates-on-two-year-fixed-mortgages-fall.aspx>). However, it is important to note that the proposed 'risk pool' would involve universities setting aside 10% of additional income received through fees, which amounts to an additional 10% risk premium levied on graduate repayments. It is also unclear whether the insurance of this 'risk pool' might also permit the private lender to cover the costs of mechanisms to protect low earners, such as a debt write-off period.

<sup>56</sup> A key difference between this model and those suggested previously is that each student would 'see' two different loans, with different repayment conditions: the first obtained from the SLC, the second obtained from the bank (though income-contingent repayments would still have to be collected by the SLC or equivalent body, with access to information on graduates' income). In the case of top-up fees where universities themselves would seek to capitalise deferred contributions, students would see only the headline level of contribution which they would agree to repay as graduates. Although some of these repayments would go the Government and some to the University/private sector investors, the student would only relate with the SLC or equivalent, and continue making repayments to that body at the same rates.

might be able to negotiate more generous deals. Other institutions might feel unable to charge higher prices if unable to secure similarly generous repayment conditions for their students. It is therefore difficult to predict the precise conditions which might be feasible for private lenders.

<b>Individual, private loans on an income-contingent basis</b>		
How they address the key questions asked by the Review		
1) <i>Ensure sustainability for higher education as a whole</i>	✓✓✓✓	<ul style="list-style-type: none"> <li>• <i>Provide additional funding for universities through increased graduate contributions</i></li> <li>• <i>Coupled with an improved student support system, would reduce long-run costs to the taxpayer</i></li> <li>• <i>Limits public borrowing to finance student loans</i></li> <li>• <i>Caveat: Risk premiums on individual student loans are likely to be large (therefore relatively high interest rates); if universities underwrite some or all of the loans, they will bear a significant risk</i></li> </ul> <p>(Risk level: 3)</p>
2) <i>Mechanisms to drive up quality and efficiency in higher education</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Coupled with increased graduate contributions, would facilitate variable pricing and encourage students to be more demanding.</i></li> </ul>
3) <i>Incentivising participation</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Reduced burden on public purse could allow increased student numbers (although we believe that improving quality is a greater priority than expanding numbers)</i></li> <li>• <i>More affordable to extend student support beyond full time undergraduates.</i></li> </ul>
4) <i>Promoting fair access</i>	✓✓✓	<ul style="list-style-type: none"> <li>• <i>Additional income for universities to encourage fair access through bursaries and widening participation initiatives</i></li> </ul>



## 5. Graduate contributions: Why a general ‘tax’ is the wrong option

- 5.1 Some commentators have argued that a graduate ‘tax’ is a fairer means of facilitating graduate contributions to higher education than fees and loans. Yet there are important reasons why this kind of taxation is both unfair and unsustainable.
- 5.2 *No clear benefit to students:* The current system of fixed contributions supported by income-contingent loans is similar to a graduate tax, but one which is capped at a fixed price. It therefore has all the key benefits of a graduate tax – that students are not required to pay anything up-front, and their contribution is linked to their earnings as graduates, without the significant disadvantages discussed below.
- 5.3 *Overpayment:* A key difference between set graduate contributions and additional taxation is that the latter breaks the link between what graduates repay and the costs of their study. Under the graduate tax system recently proposed by the National Union of Students, some graduates would pay back a great deal more than the cost of their own tuition. The NUS estimates that a tax system would eventually provide additional investment equivalent to £5,000 per year tuition fees for all students. But we estimate that under these proposals:<sup>57</sup>
- the lowest 20% of earners would gain no benefit
  - average graduate earners would pay the equivalent of a £5,000 per year tuition fee
  - graduates in the upper 20% of earners would pay the equivalent of tuition fees of at least £16,000 per year.
- 5.4 Average salaries for graduates in this latter group are £20,000 in the first year post-graduation, rising to £86,000, 20 years post-graduation – the kinds of salaries paid to senior academic professors or heads of department, senior civil servants or NHS managers. Such a vast overpayment on the part of thousands of graduates in this income group would be unreasonable and likely to be seen by many as unfair. Moreover, given the recent introduction of the 50% income tax rate, increases in National Insurance payments, and the possibility of further tax rises following the General Election, there will probably be even less of an appetite for a new graduate tax.
- 5.5 Moreover, if maintenance loans are taken into account, the proposed graduate tax system offers little or no benefit for low-earning graduates in comparison with the current system. It is also important to note that, although the higher education sector would receive the same amount of income from the graduate tax proposed by the NUS as from raising tuition fees to £5,000, under the NUS plans graduates would foot the entire bill. In the current system, the Government writes off the debts of lower earners after a fixed period, meaning that taxpayers share some of the cost of tuition fees. In effect, the NUS proposals transfer most of the cost of these subsidies for lower earners onto moderately high-earning graduates, rather than the Government.

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<sup>57</sup> These figures assume fees paid under the current system, with no real rate of interest. Since the NUS proposals do not consider maintenance loans, for the purposes of comparison it is assumed that maintenance loans continue as currently, and that tax repayments only begin once the maintenance loan is paid off. For the lowest earning graduates, debt write-off after 25 years means they do not pay off the value of their maintenance loan, so effectively don't pay any fees under the current system. If maintenance loans are not considered, the lowest earners would pay marginally less under the graduate tax system, whereas middle and higher earners would pay significantly more. A note on detailed modelling and assumptions used can be provided on request

- 5.6 *Breaking the link between price and quality:* In contrast to the competition generated by fixed prices which could be set by universities, a graduate tax would provide little incentive or adequate resource for universities to drive up quality. Furthermore, although graduates would make different contributions according to their earnings, this entails a somewhat simplistic approach to pricing the different benefits which graduates secure from their education, which fails to take into account the overall undergraduate experience or overall experience in later life. It therefore perpetuates much of the unfairness of applying the same price to very different modes of education.
- 5.7 *High up-front cost:* Raising investment in universities through a graduate tax would require a major up-front investment by Government which it would be unable to recover. The only alternative would be many years of under-investment in universities until the graduate tax revenue becomes available. But unlike loans, the Government would not be able to raise cash to support these costs through the sale of debt. A large increase in up-front, non-recoverable spending on higher education is unlikely in the current economic climate.
- 5.8 *Loss of charitable contributions:* The NUS proposes that a graduate tax should be levied for 20 years post-graduation. It is likely that the ongoing expense of a graduate tax would greatly reduce the inclination of graduates, especially high-earning ones, to give voluntarily to their former university. In recent years this has become a growing and more important source of income for universities.
- 5.9 *Hypothecating tax revenues:* There are very few examples of the UK Government ring-fencing future tax revenues for a specific purpose. It is far from clear whether graduate tax revenues could be ring-fenced for investment in higher education. Higher education institutions and future students would be taking a risk that future political leaders would remain committed to higher education.
- 5.10 *Revenue from EU students:* Another practical difficulty with a graduate tax system is that of securing payments from EU graduates, or other graduates living overseas. Securing these payments is already problematic under the current system, but the obligation and expectation is at least there that graduates will repay their loans, regardless of future mobility. It would be difficult in the extreme to levy and collect a graduate tax from graduates living and working overseas. This may also introduce perverse incentives for our best graduates, both home and EU, to move abroad and deprive the UK of vital skills and knowledge.

## 6. Conclusion

- 6.1 This submission has shown that, in response to severe and ongoing financial pressures on the higher education sector in the UK, an increase in graduate contributions should be part of the solution to sustaining the quality of education and research in our leading universities.
- 6.2 Managing the introduction of additional contributions in a manner which protects students, supports widening participation and fair access, and yet does not place an insupportable burden on public finances presents a considerable challenge.
- 6.3 This submission has not sought to provide a definitive solution to that challenge. Instead, it has outlined some suggestions for reform of the current system of student support which, together or in combination, might help to raise the investment which universities need to remain competitive, in a manner which is both fiscally sustainable and protective of the imperative to ensure participation in higher education by all who can benefit from it.
- 6.4 The submission has discussed increasing graduate contributions, supported by public loans or a combination of public and private loans. It has also explained why a 'graduate tax' would be the wrong option for the future funding of UK higher education. Although many details remain to be resolved, these proposals address some key questions about how a student support system can be funded sustainably in the future and achieve an appropriate balance of different funding sources – both private and public.
- 6.5 The Russell Group is committed to working with the Review, Government, students and the wider public to achieve an improved system of higher education funding that is sustainable in the long term, protects students and the widening participation agenda, and at the same time can help provide the level of resources which the UK's research-intensive universities will need to remain competitive now and in the future.

## Annex A: The role of bursaries in promoting access

1. Concerns around the likely impact of higher graduate contributions upon access often overlook the fact that they would provide universities with more resources to recruit and support students from lower-income backgrounds. This could involve greater resources devoted towards new or existing widening access initiatives. If thought necessary, it could also support larger bursaries and scholarships for students from lower income backgrounds.
2. It is important to recognise that there is a robust body of evidence which demonstrates that academic attainment before the age of 18 is the most important factor in whether a student will go on to higher education, not financial considerations. When A-level grades are taken into account, students from deprived and higher-income families are equally likely to go to university.
3. However, there is also evidence which suggests some students may currently be put off applying to a Russell Group university as a result of false preconceptions, misinformation, lack of confidence or misunderstandings about the costs and financial support available. Russell Group universities already undertake a wide range of outreach activities to help remove these barriers by raising levels of awareness and understanding of their institutions amongst school pupils. Special entry routes, for example, support access by students from low participation groups who lack the academic qualifications otherwise necessary for entry to a highly selective institution.
4. As an additional measure to help overcome the barriers to participation, Russell Group universities offer very generous bursaries to students from low-income backgrounds. Research for OFFA has noted that bursaries can be an effective tool for more selective universities to increase recruitment of students from widening participation backgrounds. A recent report finds that bursaries are effective at 'encouraging high-achieving lower-income students to opt for more selective universities and colleges'.<sup>58</sup>
5. Since the introduction of the fees regime, all our institutions have greatly increased the amount of financial support given to students from low income families through bursaries. OFFA data attests to the considerable efforts Russell Group universities have made to help less well-off students. In 2007/08, Russell Group universities spent between them £40 million on bursaries and scholarships, and more than £5 million on additional outreach activities. On average, they devoted 26% of their additional fee income (AFI) towards bursaries, scholarships and widening participation initiatives – a greater share of AFI than the sector as a whole.<sup>59</sup> In 2007/08, the average bursary offered by Russell Group universities to students receiving a full grant was £1,500; twice the average level offered by the sector as a whole, and around 5 times the minimum bursary required by the Office for Fair Access.<sup>60</sup> In response to evidence from across the sector that there is an uneven awareness and understanding of bursaries amongst students, Russell Group institutions have recently been improving the transparency of their information about bursaries.
6. For this valuable tool to be retained, it is important that in any future funding system bursaries remain linked to the level of graduate contributions required for a particular institution or course, and under the control of individual institutions. Recently, Sir Martin

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<sup>58</sup> Claire Callender (Ibid)

<sup>59</sup> OFFA, *Access agreement monitoring: outcomes for 2007/08*, March 2009

<sup>60</sup> Claire Callender *Awareness, take-up and impact of institutional bursaries and scholarships in England*, A report to the Office for Fair Access (November 2009)

Harris has reiterated his support for institutionally determined bursaries, stating that they remain the only financial tool to help mould students' choice of university.

7. Several organisations have advocated a national bursary scheme. Calls for such a scheme would be understandable if there were no financial assistance available for students in need. But this is not the case. The current system of student support in England is one of the most generous in the world. We already have a 'national bursary scheme' in the form of a guaranteed level of support for disadvantaged students through government grants, subsidised loans and no upfront fees. A national bursary scheme would effectively increase the basic level of support for all students in particular circumstances, something that would be addressed more effectively through grants and loans.<sup>61</sup>
8. There is no evidence that a national bursary system would widen participation, and it is likely to hamper the efforts of Russell Group universities to encourage students from non-traditional backgrounds to apply. Potential students should be encouraged not only to progress to higher education but also to choose the university and course that best suits their aptitude and maximises their life-chances.

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<sup>61</sup> Martin Harris, oral evidence to the Independent Review of Higher Education Funding; available to download from <http://hereview.independent.gov.uk/hereview/2010/02/videos-of-public-hearings/>

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