

**Unfair deal: The effects of the 2015 summer budget on students: Full report**

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Disclaimer: All opinions herein are those of the author and do not necessarily represent the views of the Sutton Trust

## **Abbreviations**

BIS	Department for Business, Innovation & Skills
HEFCE	Higher Education Funding Council for England
HEIPR	Higher Education Initial Participation Rate
HESA	Higher Education Statistics Agency
HMT	Her Majesty's Treasury
IFS	Institute for Fiscal Studies
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
OFFA	Office for Fair Access
RAB	Resource Accounting and Budgeting
THE	Times Higher Education
UUK	Universities UK

## **The 2015 Summer Budget higher education fix - its impact on social mobility**

### **Introduction**

The changes to higher education introduced in 2012 promised much. They would ensure universities had adequate resources while making savings in public expenditure. There would be no up-front costs for students from low income backgrounds, and their money to spend while at university would be increased through a combination of bursaries, grants and loans. Though debts would be greater, the repayment terms ensured that former students on lower incomes would have lower repayment rates than under the previous arrangements.

These features were achieved through increased student debts and very long repayment periods, resulting in great uncertainty as to how much would actually be repaid. Critics of the scheme argued that the estimates of future earnings were optimistic, and that the fee levels, and hence loan levels, would be higher than had been assumed, which together meant that the costs to government would be higher than anticipated. Eventually official unit cost estimates increased. In addition, government is removing controls on student numbers, and has given private providers more opportunities to recruit students with government subsidised loans, both of which will increase uncertainty and total costs.

Further, government now emphasises the impact of policies on the national debt (Public Sector Net Debt) in the relatively short to medium term, rather than the costs to government after taking into account expected repayments over future decades.

This is the background which has led to the changes set out in the 2015 Summer Budget. Two of those changes, the scrapping of maintenance grants and the proposed changes to the terms for student loans, have a particular relevance to social mobility and will be discussed in some detail, but first the other changes announced in the Summer Budget are described as they need to be understood as part of the total higher education package.

### **Selling income contingent student loans**

'Pre-Browne' income contingent student loans, that is loans taken out by students starting between 1998 and 2011, are to be sold off in tranches starting in the current financial year (2015-16) through to 2020 (HMT, 2015, page 29, paragraph 1.101). This follows previous announcements and confirms government's preference for early contributions to reducing the national debt, even if this means increased net costs in the longer term (McGettigan, 2015a).

So far it has seemed unlikely that sales of the loans provided to students starting from 2012 and later could meet the tests for value for money. However, if the sales of pre-2012 loans become an established national debt reduction stream, then this would provide an incentive to find ways of selling the loans to students starting from 2012, which in turn would provide an incentive to change the loan terms and

conditions. It is the present loan terms that make these unattractive to potential purchasers.

### **Increasing the maximum tuition fees**

From 2017 institutions will be allowed to increase tuition fees above £9000 in line with inflation (HMT, 2015, page 59, paragraph 1.266), subject to showing they offer high-quality teaching<sup>2</sup>. This is unlikely to provide a long term fix. Salaries make up a large part of universities' costs, which probably explains why OBR increase fees by average earnings rather than inflation for their long term projections (OBR, 2015, page 56, table 3.1). And UUK have argued that even universities' non-pay costs have increased faster than inflation (UUK, 2015a, page 43).

It is likely that student loans for fees will increase in line with inflation from 2017, and, if fees are going to be the main source of universities income for tuition, loans will have to increase by more than this in the long term.

### **Reviewing the discount rate**

The discount rate<sup>1</sup> which is used to calculate the current value of future student loan repayments is to be reviewed. Whatever the outcome of this review, it will not change the amount or timing of the repayments, and will therefore have no impact on the national debt. If the rate were decreased there would be a cosmetic decrease in the budget deficit, but this would not, of itself, lead to an increase in the resources available (see McGettigan, 2015b).

### **Maintenance grants**

Means tested maintenance grants, made to students from the lowest income backgrounds, are to be replaced by an increase in the means tested loans, which will add up to an increase of £550 pa income at university for those students who meet the criteria (IFS, 2015). This proposal is due to be introduced in 2016-17, and is not subject to consultation. The Chancellor, George Osborne, argues that there is a 'basic unfairness' in 'asking taxpayers to fund the grants of people who are likely to earn a lot more than them'<sup>2</sup>.

Grants were introduced in the belief that students from low income households were more likely to be discouraged by high levels of debt. In answer to this point, the following claim was made in the Summer Budget Report:

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<sup>1</sup> The discount rate used currently is composed of the RPI and 2.2 per cent. If the RPI were 3.0 per cent a £100 repayment in 30 years time would be currently valued at  $100/(1.030 \times 1.022)^{30} = £21.45$ .

<sup>2</sup> [www.gov.uk/government/speeches/chancellor-george-osbornes-summer-budget-2015-speech](http://www.gov.uk/government/speeches/chancellor-george-osbornes-summer-budget-2015-speech)

‘There is evidence that students are more concerned about the level of support they receive while studying than the long-term repayment of their income contingent loans.’ (HMT, 2015, page 59, paragraph 1.264).

The UUK Student Funding Panel report is cited as the source. In fact the conclusion from this report was somewhat more nuanced:

‘current students are more worried about the level of maintenance costs than about long-term debt from student loans, and would like options for increasing funding to meet living costs to be explored. However, this finding needs to be treated with some caution, given the tendency for individuals to give greater weight to losses (and gains) in the present than the future. It is unclear whether current students would be more concerned with loan repayments if they were asked the same question in 10 years’ time, and what impact increased levels of overall debt may have on graduate behaviour in the future.’ (UUK, 2015a, page 18)

The point about the longer term effects of policies is well made. However, even this conditional conclusion is somewhat misleading about students’ concerns. Two questions from the Panel’s survey of current home undergraduates show the extent of concerns about support at university and the repayment of student loans. The responses are shown in table 1.

Table 1: Concerns about living costs and student loan repayments

	Unconcerned	Concerned
How concerned are you about meeting the costs of living during your course?	20.6%	79.4%
How concerned are you about your ability to repay your student loan after your course?	37.3%	62.6%

Notes: From figures 17 and 21 of UUK (2015b). Four responses (Very concerned, quite concerned, quite unconcerned and very unconcerned) collapsed to two responses. Concern about loans is the average for first, second and third year students.

While concerns about living costs are more prevalent, most students are concerned about repaying student loans. Note that these figures refer to all students, not just those in receipt of maintenance grants. A recent survey of 16 to 18 year-olds also showed that the majority of these students (58%) are either fairly concerned or very concerned about repaying student loans after they finish studying (ComRes, 2015).<sup>3</sup> The evidence from the UUK survey also shows that while students’ understanding of many features of the loan scheme is weak, most do understand the significance of

<sup>3</sup> ComRes interviewed 1,017 young adults in the UK aged 16-18 online between May 25 and June 5, 2015. Data were weighted to be representative of all young adults by age, sex and region. Full data tables can be found at: <http://comres.co.uk/>.

the income threshold for repayments, below which repayments need not be made. We cannot assume that students' concerns about repaying student loans would be the same, were the terms of those loans to change, especially if this led them to expect further changes before they had fully repaid or had their debt written off.

Arguments have been made both for and against scrapping grants, but we would expect that even those who are quite sanguine about this change would be less sanguine if government had announced that students who started in 2012 will have their grants nullified and the total received added to their student loan debt. Yet one of the measures that government is proposing is not very different from this.

### **Changing the terms of student loans**

Scrapping maintenance grants has received much attention, but, though it would result in very high headline debts, in excess of £50,000, the impact on students and government finances without other changes is not as great as might be expected. It has been estimated that with the current repayment criteria, 65 per cent of those eligible for a full maintenance grant would have no increase in repayments with the change from grants to loans, and the overall long-run costs to government would be reduced by just three per cent, while an increase in the up-front student support would lead to a short term increase in government debt by £340 million per annum (IFS, 2015). The proposal to scrap grants can only be understood in the context of proposals to change the terms of student loans.

#### **Reassurance from government - Extracts from 'Student finance myth buster'**

##### **"Q - I'm worried that I'm going to be saddled with a lifetime of debt as a result of the changes**

A – A graduate earning £25,000 per year would repay their loan at a rate of £6.92 per week. If earnings fall, then the repayments will fall as well. Graduates won't have to pay back anything until they are earning more than £21,000 a year.

The £21,000 earning threshold will be updated annually in line with earnings from April 2016.

Any outstanding payments will be written off after 30 years. If you are in lower paid work or unpaid work (which may include time bringing up a family) you won't be asked to make a contribution."

##### **"Q - Paying back higher fees means I'll never get a footing on the property ladder**

A - The Council for Mortgage Lenders advise that a student loan is very unlikely to affect your ability to get a mortgage. Mortgage lenders usually take account of your monthly net income. Under the new scheme, graduates will have a higher monthly income because the increase in the repayment threshold means that they will be making lower monthly repayments on their student loans."

The loan repayment conditions for entrants since 2012 include an income threshold, set at £21,000, to be updated annually in line with average earnings. It was this feature that enabled government to reassure potential students and to explain why they should not worry about their headline debt total. The 'Student finance myth buster'<sup>4</sup> is a good example of this advice.

In order to reduce the cost to government of the loan, and to speed the rate of repayments, subject to consultation, government is proposing to freeze the threshold at £21,000 for five years, rather than maintaining its value relative to average earnings as promised. There are two options (BIS, 2015b):

- Option 1, government's preferred option, is to freeze the threshold at £21,000 for five years from 2016. This change would apply to all students starting from 2012 onwards;
- Option 2 is to update the threshold by average earnings until 2020, after which it will be frozen for five years. This change would only apply to students starting from 2016 onwards.

There are no definite proposals for the end of the five year freeze. For both options the threshold will then be reviewed. The repayment terms also include a maximum interest threshold<sup>5</sup>, set at £41,000 pa in 2016, currently to also be updated by average earnings. When asked, BIS have refused to clarify whether it is planned to freeze this threshold as well, or even what assumption was made in producing the illustrative statistics presented in the consultation<sup>6</sup>.

The justification<sup>7</sup> for freezing the repayment threshold is that,

'the proportion of borrowers liable to repay when the £21,000 threshold takes effect in April 2016 is lower than was expected when the policy was initially introduced', (BIS, 2015, page 3, paragraph 3.)

However, the loan terms announced in 2010 which reassured potential students and led to Parliament giving its approval<sup>8</sup>, were firm proposals, not an indication of what they had in mind, or contingent on the accuracy of OBR's projections.

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<sup>4</sup> <http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/policies/higher-education/students/student-finance/myth-buster>

<sup>5</sup> The interest rate increases linearly from (RPI+0) per cent at £21,000 pa (in 2016) to (RPI+3) per cent at £41,000 pa (in 2016).

<sup>6</sup> The refusal to clarify this and other assumptions that must have been made in preparing the consultation statistics was justified by arguing that it 'would be inequitable to share further information with some respondents and not all.' A FOI request has been submitted.

<sup>7</sup> The low growth in earnings is not the only reason for the increase in costs from what government had expected. For example, it was thought that the £9,000 fee would only be charged in 'exceptional circumstances'.

Freezing the threshold may seem like a minor technical adjustment, and that may be why it has received much less attention than the scrapping of grants, but it would lead to significant increases in the repayments borrowers would have to make.

Table 2 shows the extra repayments expected from introducing a five year freeze of the repayment threshold at £21,000 from 2016, with the maximum interest threshold (£41,000 in 2016) continuing to be uprated by average earnings. It is also assumed that after five years the annual uprating of the repayment threshold by average earnings is resumed.

Table 2 – Average repayments for students starting in 2014 with and without five year payment threshold freeze (£, 2016 prices)

		2018-27	2028-37	2038-47	2018-47
No freeze of repayment threshold	Men	10,300	15,500	9,100	34,900
	Women	6,700	10,400	9,300	26,400
	All	8,300	12,700	9,200	30,200
Five year freeze of repayment threshold	Men	11,800	16,500	8,800	37,100
	Women	8,100	12,000	9,600	29,700
	All	9,800	14,100	9,300	33,100
Extra repayments from five year repayment threshold freeze	Men	1,500	1,000	-200	2,300
	Women	1,400	1,600	300	3,300
	All	1,400	1,300	100	2,800

Notes: 2014 starters for 3 year course with loans of £12,000 per year. All values shown to nearest £100. Calculated using the simplified student loan repayment model (BIS, 2015a), with default parameters except for the 'threshold lower' (Sheet RABcalc) modified for threshold freeze. The nominal repayments were taken from sheet Database, and converted to 2016 prices with RPI.

The repayments are shown in 2016 prices, calculated using the RPI measure of inflation. No further discounting has been used as there is no one right way of determining the value of future pounds for different individuals. The repayments are shown in three ten year periods, so an 'eyeball' discounting may be made.

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<sup>8</sup> The main features of the loan terms were presented to the House of Commons on 3 November 2010. The frequency of threshold uprating was announced later in a Ministerial Written Statement by Vince Cable on 2 December 2010.



The repayments relate to a borrower on a three year course with total loans of £36,000. This is a typical set of conditions, giving an indication of the pattern of repayments, but it does not represent all students. These students started in 2014 and they will start to repay in 2018, so that, were the five year repayment threshold to be introduced, they would not see the full impact until their third year of repayments, in 2020.

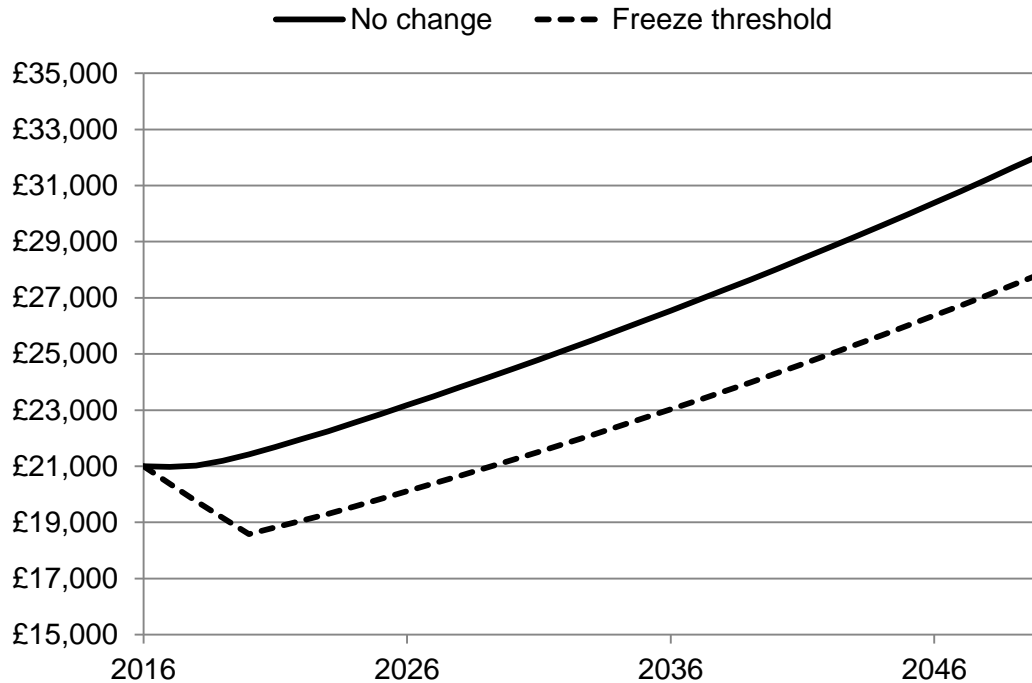
The increase in repayments for any individual will depend on the particular pattern of earnings, the size of the loan, and the way future repayments are valued. In general, we would expect those on low lifetime earnings, who repay through the whole 30 years, to see bigger increases than those who earn enough to repay their loan, though, of course, somebody whose income was below the threshold throughout the repayment period, even after the threshold freeze, would not be required to make any repayments. The smaller increases, or even decreases, for those on higher incomes are illustrated by the examples shown in the consultation (BIS, 2015b, paragraph 42). Using more realistic data the analysis commissioned by UUK shows similar results (UUK, 2015a).

The results shown in table 2 are consistent with this tendency for those on higher incomes to see smaller increases in repayments as a result of a threshold freeze. On average women's earnings are lower than men's, which results in lower average repayments. Over the first ten years, while their proportional increase in extra payments is greater than for men, in absolute terms it is slightly smaller. However, thereafter, and overall, women's repayment increases are greater.

Apart from the case of men in the final ten years, the increases in repayments can be seen well beyond 2020, the last year of the threshold freeze. This is because the threshold values after 2020 are still lower than they would have been, even though under this option the annual uprating by average earnings has been reintroduced. It is possible that the review could restore the threshold to what it would have been without the freeze, but that seems most unlikely.

Figure 1 shows how the threshold changes with and without the repayment threshold freeze.

Figure 1: Repayment threshold with and without five year freeze from 2016



It is quite possible that the review after five years would not resume the uprating by average earnings. Also, the figures in table 2 were based on the assumption that the maximum interest threshold would not be frozen, which is a possibility even though it is not mentioned in the consultation. Table 3 shows the repayments which would be expected were both thresholds to be frozen, and for two other options after the initial five year threshold freeze.

Table 3 – Average extra repayments for students starting in 2014 with different changes to loan terms (£, 2016 prices)

		2018-27	2028-37	2038-47	2018-47
Five year freeze of repayment threshold	Men	1,500	1,000	-200	2,300
	Women	1,400	1,600	300	3,300
	All	1,400	1,300	100	2,800
Five year freeze of repayment and maximum interest threshold	Men	1,500	1,200	200	2,900
	Women	1,400	1,700	700	3,700
	All	1,500	1,500	500	3,400
Five year freeze of both thresholds and twenty five years linked to RPI.	Men	2,000	2,700	900	5,700
	Women	1,800	3,500	2,400	7,700
	All	1,900	3,200	1,700	6,800
Thirty year freeze of repayment and maximum interest threshold	Men	3,000	5,000	800	8,900
	Women	2,800	6,600	3,400	12,800
	All	2,900	5,900	2,300	11,000

Notes: 2014 starters for 3 year course with loans of £12,000 per year. All values shown to nearest £10. Calculated using the simplified student loan repayment model (BIS, 2015a), with default parameters except for 'threshold lower' and 'threshold upper' (Sheet RABcalc) modified for different scenarios. The nominal repayments were taken from sheet Database, and converted to 2016 prices with RPI.

Taking each of the four changes in loan terms in turn:

- The first pair of rows repeats the option set out in table 2;
- The second change has a five year freeze on both the repayment threshold and the maximum interest threshold, followed by uprating of both in line with average earnings. Freezing the maximum interest threshold does not have a material impact on repayments in the first ten years, thereafter repayments are higher;
- The third scenario has both thresholds frozen for five years, but in this case the review has decided to uprate the thresholds by the RPI rather than average earnings until 2047. This results in a significant increase in the expected repayments for men and women across all three ten year periods.

This shows how significant the review might be, and how concerning it is that there is no indication of what it might recommend;

- Finally, this is a more extreme review decision, where the freeze on both thresholds continues through to 2047. Further large increases in the extra repayments are expected.

These estimates are based on a subset of borrowers using a simplified calculation. The earnings, and hence repayment, estimates are uncertain. Nevertheless, the results show that far from a small technical change, the proposals represent a significant increase on average in the cost of going to university. They also show how uncertain these increases are, given that the terms in future are subject to review.

#### Loss of grant with change of loan terms

As already noted, IFS have estimated that with the current loan terms, 65 per cent of those who were eligible for full maintenance grants would have no increase in repayments with a change from grants to loans. The remaining 35 per cent would contribute an average of £9,000 net present value in increased repayments, giving an overall average of about £3,000 for all those students who would have had full grants. With a threshold freeze this £3,000 average increases to £7,000 (McGettigan, 2015c). (NB these figures cannot be compared with those in tables 2 and 3, as they are discounted by RPI and 2.2 per cent.)

#### Changing the loan terms for existing borrowers

The terms and conditions for students' loans include the following:

'When you take out a loan, you will sign a declaration form which will be a contract. This states that you have read and understood the Terms and Conditions. You must agree to repay your loan in line with the regulations that apply at the time the repayments are due and as they are amended. The regulations may be replaced by later regulations.' (2012 entrant version, BIS, 2011)

Few student advisors pointed out and explained the potential consequences of this 'get out' clause; for example the government's own 'Myth Buster' does not mention it. Government ministers went out of their way to emphasise the 'generous' repayment terms without any reference to the fact that they could be changed.

By 2012, concerns that government was under-estimating the costs of the loans were growing, and the Business, Innovation and Skills Committee asked the then Minister for Universities and Science, David Willetts, whether students knew what they were signing up for far into the future. He replied that, 'under successive governments, in the letter that every student gets there are some words to the effect that governments reserve the right to change the terms of the loans'. He went on to say that there were no plans to change the terms from what had been set out. Furthermore, while acknowledging that the cost of the loans was not known for

certain, he said that government's view was that costs would be about the same as originally estimated, and that their estimates had been checked by the OBR<sup>9</sup>.

More recently, during the 2015 election, following rumours that a retrospective change in loan terms was being considered, David Willetts' successor, Greg Clark, was asked whether his party was committed to protecting borrowers' conditions. This was his reply<sup>10</sup>:

'The strength of our system is that it is robustly sustainable – as the OECD has confirmed – without any changes in terms being needed.'

Most students who had taken out these loans would not have an inkling that government would soon be proposing to change the terms even before their repayments had started. If changes are made retrospectively, then government, universities, schools, journalists and other student advisors will have been responsible for mis-selling on a huge scale; mis-selling mostly to young people aged 17 and younger. One of those advisors, Martin Lewis, founder and editor of the Money Saving Expert web site, was recruited by David Willetts to head the Independent Taskforce on Student Finance Information. He now feels betrayed. He argues that a retrospective change 'would be terrible news for confidence in higher education'<sup>11</sup>. He has pledged to do all he can to protest against the change.

Since student loans were first introduced in 1990 this would be the first time changes have been proposed that would disadvantage existing borrowers. The threshold for maintenance loans taken out from 1998 was increased from £10,000 to £15,000 in 2005 and then line with inflation from 2012. But these changes merely gave borrowers the option to make smaller repayments; systems were in place to enable borrowers to top up these new minimum payments if that is what they preferred. No change was imposed.

Would the proposed retrospective changes, which are clearly unfavourable to the borrowers, be lawful? Initial advice indicates that this is uncertain, but that retrospective changes, even with the 'get out' clause, could prove unlawful and the higher repayments unenforceable if challenged. For the discussion here it will be assumed that the 'get out' clause is sufficient to allow the changes to be made, and will consider the costs and savings that would result.

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<sup>9</sup> BIS Committee, 12 June 2012, questions 27 and 28.  
[www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/uc274-i/uc27401.htm](http://www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/uc274-i/uc27401.htm)

<sup>10</sup> THE 'Question Time: THE election panel grill the politicians'. 23 April 2014.  
[www.timeshighereducation.co.uk/features/question-time-the-election-panel-grill-the-politicians/2019742.article?page=0%2C1](http://www.timeshighereducation.co.uk/features/question-time-the-election-panel-grill-the-politicians/2019742.article?page=0%2C1)

<sup>11</sup> 'Warning: Govt may retrospectively hike student loan costs – if it does I pledge to organise protest',  
<http://blog.moneysavingexpert.com/2015/01/09/a-deliberate-threat-to-the-government-u-turn-on-the-21000-student-loan-repayment-threshold-i-will-organise-mass-protest/>

### Costs of changing the loan terms for existing borrowers

If government's preferred retrospective option were implemented, students who took out loans believing they knew the repayment terms would be faced with an increase in repayments from 2017, a review of the terms for 2021, and, what else? A precedent would have been set and future governments, facing further shortfalls, or just taking an opportunity to increase revenue, would feel free to make any changes they liked, and not only the threshold levels.

Just by proposing retrospective change government will have reduced trust, and if the proposal is implemented it will be far worse. Four cohorts are affected, over a million students. Most of them will see higher repayment rates, and their repayments in the longer term are uncertain, and potentially much higher, depending on the decisions of future governments. Their available income for their first mortgage could be significantly reduced. The loss of trust is likely to be reinforced rather than forgotten. What is the cost of this loss? Firstly, their experiences would inform the decisions of later cohorts of prospective students, undermining their confidence in taking out loans. But the cost is more general than this. It is difficult to attach a figure to it, though it is widely accepted that trust in general, and trust in government in particular, is important:

'Trust in government represents the confidence of citizens and businesses in the actions of government to do what is right and perceived as fair. It is one of the most important foundations upon which the legitimacy and sustainability of political systems are built. Trust in government is essential for social cohesion and well-being as it affects the government's ability to govern and enables government to act without coercion.' (OECD, 2013)

### Savings from changing the loan terms for existing borrowers

There would be a one off saving for government from freezing the threshold for all students (option 1) compared with keeping the original terms for the four cohorts starting from 2012 to 2015 (option 2). The consultation reports a net present value estimate of these savings at £3.2 billion (BIS, 2015b, page 17, paragraph 56). The increased repayments would be made over about thirty years, with the maximum for any one year less than £200 million<sup>12</sup>.

It is hard to estimate what long term differences between the two options would be. Under option 2, starters in 2016 would have a higher initial threshold than with option 1 in 2020, but the relative impact of a freeze over the next five years would depend on the increase in average earnings, relative to the increase under option 1 freeze. The figures produced by BIS suggest option 2 would produce bigger long term

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<sup>12</sup> Estimated from the chart at BIS, 2015b, page 17, paragraph 58.

savings than option 1<sup>13</sup>. Under both options the actual savings would also depend on what was decided at the five year review. There is nothing to stop government from ensuring that the long term ongoing savings for option 2 are the same or higher than they would have been for option 1.

These savings are less relevant now that government's priority is to reduce the national debt as a percentage of the GDP rather than reducing the budget deficit. The debt, unlike the deficit, does not take account of future student loan repayments. This means that option 2 'would not contribute to the government's fiscal objective of bringing down debt in this Parliament' (BIS, 2015b, page 15, paragraph 47). The contribution by option 1 is about £420 million or less than 0.03 per cent of the national debt<sup>14</sup>. Is this a price worth paying for the loss of trust?

### Student loan terms over the long term

Though option 2 avoids the retrospective element of option 1, both make a fundamental change to the terms and conditions. Previously, though there was a 'get out clause', it was generally assumed that the terms would not be changed over the repayment period in a way that was unfavourable to the borrowers. Martin Lewis, one of the few advisors to even acknowledge the possibility of such a change, thought that, though there was no 100 per cent guarantee, it was unlikely that borrowers would see an unfavourable change, and that it was therefore best to work on the assumption that the loan terms in place when they took out their loans would continue throughout their repayments<sup>15</sup>.

The new proposals completely change the rules of the game. Even with option 2, there can be no assumption that the terms and conditions will be not be changed for 2016 and subsequent starters; the expectation must be that they will be changed. For both options we are given no guarantee about the terms after the threshold freeze, only that there will be a review, with no steer as to what will be the scope of that review other than it will look at the threshold, nor what will determine its outcome.

We can get an idea of what government thinking is on the long term arrangements by looking at what those who were at the centre of decision making have written since

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<sup>13</sup> Option 1 is estimated to result in an additional £0.9 billion repayments per £15 billion loans, option 2 £1 billion (BIS, 2015b, page 17, paragraph 57)

<sup>14</sup> NPV of repayments taken from the chart at (BIS, 2015b, page 17, paragraph 58). The discounting by 2.2 per cent was reversed to give the real value of the repayments in 2016 prices. National debt taken as £1505.3 billion from [www.ons.gov.uk/ons/rel/psa/public-sector-finances/index.html](http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/index.html)

<sup>15</sup> Student Loans Mythbusting – tip 24. [www.moneysavingexpert.com/students/student-loans-tuition-fees-changes](http://www.moneysavingexpert.com/students/student-loans-tuition-fees-changes)

leaving. In January 2015, shortly after leaving his post as Director of Higher Education, Matthew Hilton wrote that,

‘the government could reduce the RAB charge [a measure of government loan subsidy – JT] to whatever it wanted at a stroke . . . If interest rates, repayment levels etc. were able to flex in line with the macro-economic context, the RAB issue would go away. But the politics doesn’t allow for that. The requirements that matter are not those of rational economic behaviour, but of the need to manage all the angles in a way that keeps the politics on track’ (Hilton, 2015).

Shortly before the Summer Budget policies were published, former Minister for Universities and Science, David Willetts, wrote an article that anticipated the official announcements in the Summer Budget. He also proposed regular five year reviews to ‘allow adjustments to the parameters of the system in order to keep it flexible and sustainable’ (Willetts, 2015). Everything points<sup>16</sup> to a system where the terms are changed at regular intervals through the repayment period, shifting the risks inherent in the loan scheme from government to borrowers. Students would be required to write an ‘open cheque’.

If ‘the politics’ is the only thing that prevents this vision being set out, we can expect it to be introduced by stealth. Once varying terms were established there would be a risk that future governments would go further, and use student loans as an easy way to raise revenue, a government cash cow, by increasing interest rates, introducing early payment charges, or extending the repayment period, and so on. If the terms could be made sufficiently unfavourable to students then selling the post 2012 loan book might become possible.

The ‘get out’ clause which allows government to change any of the student loans terms and conditions over thirty or more years has been seen, if it has been noticed at all, as representing no more than a theoretical risk to borrowers from previous legislation. But now it is looking like a key component for making higher education finances ‘sustainable’. Denning in his famous ‘red hand rule’ of contract law said,

‘the more unreasonable a clause is, the greater the notice which must be given of it. Some clauses which I have seen would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient’.

Being able to change any loan conditions at any time would seem to be pretty high on an unreasonableness scale, so what kind of a health warning would be

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<sup>16</sup> There is some indirect evidence that this is what Government is preparing for. The consultation includes a discussion of the potential increase in administrative burden arising from option 2 compared to option 1 for those employers of former students who assist with student loan repayments. If no further reviews were anticipated, the difference between three schemes (option 1) and four schemes (option 2), seems unlikely to be an issue. But frequent reviews through the repayment periods which gave students guaranteed terms could lead to many more schemes.



appropriate for those advising prospective students about taking out a student loan? Something like the following:



**'Government may change these loan terms at any time. These terms are based on current Government long term cost estimates which are highly uncertain. Should these estimates prove inaccurate, or if it be decided that the loans subsidy should be reduced, it is likely that the terms will be changed and the repayments due may be significantly higher than shown.'**

To advise students to borrow without such a warning would be misleading. Would such a warning discourage students from taking out loans?

### **Social Mobility**

The White Paper, 'Higher Education: Students at the Heart of the System', introducing the 2012 changes, identified increasing social mobility as one of the key policy aims. The 2015 Summer Budget claims to be consistent with this aim by providing the resources to remove the cap on student numbers, and by increasing the money available to students from low income households while at university through an increase in maintenance loans replacing maintenance grants. These changes will increase the size of the debt for students from low income families from about £40,500 to £53,000 for a three year course (IFS, 2015). In anticipation of any concern that this might deter students it is pointed out that, despite the large increase in debt following the fee increases in 2012:

'Since 2010 student participation has increased and there is now a higher proportion of students from disadvantaged backgrounds applying to and entering higher education than ever before.' (HMT, 2015, page 59, 1.264)

In addition, research commissioned by UUK was cited as showing that students are more concerned about the level of support they receive while studying than the long-term repayment of their income contingent loans. As already shown in table 1, this is a somewhat misleading take on the research findings; a substantial majority of students are concerned about the repayments they will have to make, even with current terms and conditions.

### Participation

When the 2012 proposals were first announced it was suggested that, because the penalties for not going to university could be large and that the loan terms were generous, the disincentive from the higher fees could be less than some feared. The conclusion was that the impact of the fees would depend to a large extent on perceptions and how the arrangements were described and 'sold' (Thompson et al, 2010).

It seems that the selling was successful, at least for young entrants. They were not put off by the large headline figures of debt, and the young participation rate

continued to rise through the increase in fees. The apparent dip in young applicant rates in 2012 was due to some students electing to apply in 2011, aged 18, rather than 2012, aged 19<sup>17</sup>. The evidence for mature students is more complicated. Estimating mature application and entry rates is not straightforward and it is not yet clear to what extent full-time demand by mature students has been affected by the increase in fees. However, entry rates for 2013-14 were still lower than in 2010<sup>18</sup>. The decline in part-time study (most part-timers are mature students) has been spectacular, though the reasons for this are complex, with the rise in fees only being part of the story<sup>19</sup>.

As already shown, surveys show most students (young and mature) are concerned about their student loan debt (see table 1). What is more, when there is an opportunity to reduce costs, without significantly compromising the expected value of their higher education experience, many students take it. For example, of those who ordinarily would be expected to apply aged 19 in 2012, many applied aged 18 in 2011 instead<sup>20</sup>. The Welsh Assembly has provided a series of natural experiments with effective fee levels for study in England sometimes being higher than in Wales, sometimes not. The application rates show that differences in costs result in significant numbers of students who would have been expected to study in England, studying in Wales instead<sup>21</sup>. Students' behaviour, as well as responses to surveys, shows that they are aware and concerned about long term costs.

It would therefore be unwise to conclude that high loans will never deter school leavers, even though, to the extent that employers are using degrees to signal the abilities of job applicants, the cost of not going to university could remain high. The terms of the loan, and potential students' perception of those terms, remain important.

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<sup>17</sup> See Thompson et al, 2013, pages 28-35. For more recent UCAS analysis see UCAS, 2014 Using data from the BIS Higher Education Initial Participation tables (HEIPR) (BIS, 2015c) reconfigured to give entry at 19 and younger age cohort rates, there is no dip in entry rates for those who were 18 in 2012.

<sup>18</sup> BIS supplied the data used to calculate the HEIPR (BIS, 2015c), with entrant rates counts split by mode. These data showed that the full time initial entry rates for 2013-14 were lower than in 2010-11 for those aged: 20-24, 25-39 and 40-60. See also the application rates at Thompson et al, 2013, page 38, fig 11A.

<sup>19</sup> See Thompson et al, 2013; HEFCE, 2014b; HEFCE, 2015b, pages 8 and 9. Also HEIPR based data (see 17 above) showed part time participation rates continuing to decline in 2013-14.

<sup>20</sup> Thompson, at el, 2013, paragraphs 74 to 79.

<sup>21</sup> Thompson, at el, 2012, paragraphs 14 and 17

## Where and what to study

Overall participation rates do not capture all that we should be concerned about. There is the question of where and what students study. Potentially, concerns about levels of debt could affect students' choice of course, with students from disadvantaged backgrounds most at risk. The gap in participation rates between advantaged and disadvantaged groups at more selective institutions is large (OFFA, 2014) and, though much reduced when prior qualifications are taken into account, still remains<sup>22</sup>. The more selective universities are more likely to charge the maximum fee, so fear of debt could deter applications. Living at home can be a positive choice, but often it is a means to reduce costs<sup>23</sup>, so reducing choice. Disadvantaged students are more likely to live at home (HEFCE, 2009b), even after taking into account their prior qualifications and other factors. In the decade from 1990, which saw the gradual replacement of maintenance grants with loans, while participation increased dramatically the proportion of young students living at home increased from 8 per cent to over 20 per cent (HEFCE 2009b).

Such was the basis for concerns about how the 2012 changes with the big increases students' debt might affect students' choice of course. In the event the evidence suggests these changes did not have a significant effect. UCAS looked closely at the 2012 applications and they found no substantial move away from courses charging higher fees and no move towards living at home. Looking specifically at applicants from disadvantaged backgrounds, UCAS again found no move away from courses charging higher fees<sup>24</sup>, nor did they find a move away from more selective universities<sup>25</sup>.

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<sup>22</sup> See Chowdry et al, 2013. Also HEFCE unpublished data shows that when table 31 (HEFCE, 2015a, page 59) was restricted to institutions with high average tariff scores the participation rate differences between POLAR3 quintile 1 (disadvantaged) and POLAR3 quintile 5 (advantages) is large. For example ABB (quintile 1) 50 per cent, AAB (quintile 5) 63 per cent.

<sup>23</sup> A survey of prospective students found that 32 per cent were going to or were thinking about living at home while at university because of the cost. The percentage was higher (43 per cent) for those whose parents were in NS-SEC lower occupations (Callender et al, 2008, page 415, table 2).

<sup>24</sup> The range of fees was not large, from £6000, mostly charged by further education colleges, to £9000 for even the most selective universities. Also, disadvantaged students were likely to receive a more generous bursary at the high fee selective universities.

<sup>25</sup> See UCAS, 2012. Consistent with UCAS findings unpublished results from HEFCE shows no increase in proportion of entrants living at home through to 2013-14, and OFFA (OFFA, 2014) found that entry to more selective universities by students from disadvantaged backgrounds has been maintained over the same period.

A survey (UCAS 2013) carried out by UCAS gives us an insight into these results. When asked, 'has the increase in tuition fees influenced your choices about which courses or universities and colleges to apply to', 69 per cent of young applicants replied 'no'. 16 per cent said that they 'decided to study at home', as a result of the fee rise. We should not be surprised that this does not align with the analysis of actual behaviour; those who had decided to study at home would not always really know what they would have done without the fee increases, and it would be understandable if their response was in part a justification of their choice.

Those who answered 'no', tuition fees had not influenced them, were asked, 'why did you say that the increase in fees did not influence your choices about which courses and universities and colleges to apply for'. Table 4 shows the four most common responses selected. All the other reasons got 10 per cent or fewer responses.

Table 4: Reasons why increased fees did not influence choices (young applicants)

We don't repay until we earn the threshold salary	57%
I am still prepared to pay the fees to invest in my future	56%
We can get a loan to pay the fees	56%
Apart from university or college there is nothing else I wanted to do	23%

These figures provide further evidence of the importance of the threshold in reassuring students about their debts. While we need to be careful about interpreting responses to prompted answers, we know from the UUK survey (UUK, 2015b) that the threshold is the feature of the loans that most applicants understand. The oft repeated message, 'it's not the amount you borrow, but how much you earn that determines your monthly repayments', seems to have worked. What is difficult to assess is whether high debt levels would still not influence choices, were the threshold to be reduced and if it were understood that the terms would be regularly revised over the decades of repaying.

#### Academic success

Recent studies found that students from disadvantaged backgrounds are less successful in their undergraduate studies even after taking into account their prior qualifications and other factors (HEFCE, 2014a; HEFCE 2015c; Crawford, 2014). This underachievement was not expected. The working assumption had been that getting good A-levels for someone from a disadvantaged background provided a better indication of potential than for other students. HEFCE commissioned a review of the literature to see why less advantaged students did less well (Mountford-Zimbars et al, 2015). As might have been expected, the results of the search were

not conclusive, but there is one explanation that needs to be considered in the context of student loan debts, that is the effect of excessive term-time working.

Like living at home, term-time working has greatly increased since the first introduction of student loans, from very few full-time students to more than half working during term-time ten years later. Since then the proportion working during term-time has stabilised<sup>26</sup>. In a major study using data from seven institutions (Callender, 2008; Van Dyke et al, 2005), it was found that,

‘Term-time working and higher education achievement (as measured by end-of-year marks, and final degree outcomes) are negatively associated, even after taking into account other factors’.

To give an idea of the size of the effect, if we had two students who were similar in all respects except that one did not work during term-time whilst the other worked for 16 hours a week, if the non-working student’s chance of getting a good degree was 50 per cent, the working student’s chance would be 37.5 per cent<sup>27</sup>. There was also a wealth of evidence consistent with term-time working being the cause of the reduced achievement, rather than, say, both term-time working and lower achievement being common attributes of those students less committed to their studies. It was also found that those from ‘routine and manual households’ were more likely to work during term-time than those from professional households.

This study looked at students who qualified in 2002, when fee levels and student loans were a lot smaller and maintenance funds were less generous. No further research on this scale or detail has been completed since<sup>28</sup>. The UUK study<sup>29</sup> showed that 54.5 per cent were meeting some of their living costs by working alongside their studies, and of those 69.2 per cent indicated that their earnings from working were essential to meet their living costs. No doubt the small increase in

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<sup>26</sup> See Callender, 2008, page 360, and references therein. The most recent Student Income and Expenditure (2011/12) found that 52 per cent of full-time students worked during term-time.

<sup>27</sup> In the report this illustration was presented in terms of odd ratios, with the odds of the working student getting a good degree equal to 60 per cent of the non-working student, with 95 per cent confidence interval of 40 to 90 per cent. The wide confidence interval reflects the complexity of the modelling required relative to the sample size (Van Dyke et al, 2005, page 115).

<sup>28</sup> An earlier study (Purcell et al, 2005) based on a large representative sample of students who graduated in 1999 also found that students who worked during term-time had lower academic achievement after controlling for other factors. There have been studies based on individual institutions, for example the University of Swansea (Jones et al, 2005) and the University of Reading (Jewell, 2014) who have found the same effect for students working for long hours during term-time, again after controlling for other factors.

<sup>29</sup> UUK, 2015b, fig 18.

'cash in hand' for those from low income households, may reduce the pressure to work during term-time, but the effects of scrapping grants and the increase in loans, coupled with uncertainty about the future loan terms, risks increasing term-time working. Any change in the proportion of students who work long hours, say 15 or 20 hours a week, rather than the proportion who work at all during term-time, will be more important in determining whether students are disadvantaged at university. As yet we do not have any evidence as to whether the 2012 changes have led to an increase in excessive term-time working.

### **What will the Summer Budget changes do?**

The freezing of loan thresholds will significantly increase the average cost of higher education. Students from low income backgrounds will see the big increases in costs through the combined effect of scrapping grants and changing loan terms. Yet, large as these increased costs are, it is not the increased repayments as such which create the biggest risk, rather it is the uncertainty that has been created by the way it is proposed the changes are to be made.

The student loan scheme is often described as being like income tax, in that the amount paid can depend on the borrowers' income rather than their total debts. In other respects it is like an insurance policy. The decision to go to university is made with the expectation that it will lead to a better, higher paid job. But there is no certainty in this outcome - maybe she will drop out or fail her final examinations<sup>30</sup>, with, evidence suggests, worse prospects than if she had got a job after A-levels<sup>31</sup>. Even if she graduates, there is no guarantee of a good job; the average 'graduate premium' hides a wide range of outcomes. But the student loan terms create a safety net. If the worst comes to the worst, and she ends up earning below the repayment threshold, her financial loss will be the loss of earnings whilst studying, and no more. Knowing, as students thought they did, exactly what they were committing themselves to, is what gave them confidence to take out student loans to cover the costs of their preferred course.

We cannot say for certain what would happen if government went ahead with removing any expectation that loan conditions would apply throughout the repayment term, combined with the higher debts from the scrapping of grants. The policies have

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<sup>30</sup> Not all student loan borrowers are graduates. 14.6 cent of UK domiciled full-time entrants to degree courses at UK HEIs are projected not to graduate, and of these 10.7 percentage points are projected to gain no HE award (HESA, 2015). Non-completion rates for part-time study are much higher (HEFCE, 2009a).

<sup>31</sup> Identifying non-completers within the Labour Force Survey is difficult, but it can be done (Walker et al, 2013), and response rates for this group in other surveys are always low, though they can provide some information (McCulloch, 2014). The evidence shows non-completers do, at best, fair no better than those who never entered higher education and it is more likely that they do worse. In future student data linked to HMRC data should provide a clearer picture.

been announced without any research findings to assess students' possible responses. The possible penalty of not going to university, along with the removal of controls on student numbers, may mean that participation rates continue to rise, but with some students electing to study part-time or intermittently so that they can work and reduce debt, perhaps choosing their second or third best course if it has lower fees or allows them to live at home.

There is a risk that less favourable and changeable loan terms would result in a move towards something like higher education in the USA, where participation is high, but where the conditions of study are more unequal, with most students taking longer, with lower chance of success<sup>32</sup>. Failure to complete, reduced academic achievement, delay in graduating or graduation from a less prestigious university, and reduced time to take part in extra-curricular activities, may all impact social mobility by adding to the difficulties students from disadvantaged backgrounds find in accessing graduate jobs and the elite professions<sup>33</sup>.

### **What should be done?**

There is a debate to be had about how much public funding should be spent on higher education, and how that money should be spent. Here, however, it will be taken as a given that government's plans for a reduction in expenditure, compared to what is expected with current arrangements, will be introduced, and that this will be achieved by increasing the repayments that borrowers will have to pay. Given these assumptions, how can this policy be implemented with the least damage to public trust, and the least impact on social mobility? How can we ensure that young people are not discouraged from entering higher education and that their decisions as to what, where and how to study are not distorted by concerns about costs?

#### No retrospective changes

Until recently, nobody seriously thought that the 'get out' clause in the terms and conditions would be evoked in any circumstances other than some unforeseen

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<sup>32</sup> In the USA even young students (starting aged 20 or younger) are most likely to study part-time, either exclusively (2.9 per cent) or a mixture of full and part-time (54.2 per cent). Taking the young mixed mode students, after six years 44.8 per cent had completed, 25.1 per cent were still studying, and 30.1 per cent had not completed and were not studying. Using age unspecific statistics for an earlier cohort the young mixed mode group can be estimated to have 53.1 per cent completed, 12.8 per cent still studying, and 34.0 per cent not completed nor studying after eight years. (Shapiro et al, 2014).

<sup>33</sup> The cost of dropping out when entering the labour market has already been pointed out (footnote 30) and the value of a 'good' degree has been shown in numerous studies. The value of attending a selective institute is very difficult to separate from individual student attributes, but this has been done (Broecke, 2012). Purcell found that extra-curricular activities gave students an advantage, in particular students who were office holders or student representatives while in HE have more success in securing a graduate job. She also found that young students assumed to be living with their parents were particularly unsuccessful (Purcell et al, 2012).

national emergency. Past sales of the student loan book have included a guarantee of the loan terms, so that, as things stand, we have the odd situation where borrowers whose debt has been sold can be sure of how their future repayments will be calculated, whereas those whose debts have not been sold cannot be sure of anything - thresholds, interest rates, the write-off period, and so on. Protecting existing students involves a one-off cost of £3.2 billion, with this cost spread over three decades. It is difficult to put a financial cost on the loss of trust from making a retrospective change, but it is likely to be long lasting and very difficult to reverse. No changes to existing students' loan terms should therefore be made.

### Restoring trust

Even if no retrospective changes are made the act of proposing retrospective changes has undermined confidence. To regain trust it is necessary to remove the 'get out' clause and legislate to guarantee the loan terms and conditions. Of course, future governments could always pass a law reversing this, but such a commitment would give students more confidence in taking out a student loan.

### Terms for future students

£21,000 is higher, in real terms and relative to average earnings, than was intended when the policy was announced in 2010. This problem was of government's own making. Had they announced the threshold as a percentage of average earnings, as was and is the case for loans before 1998, the uncertainty created by estimating inflation and future earnings would have been avoided. It seems likely that they chose a nominal figure to make the terms seem better than they were<sup>34</sup>.

This history provides a justification for lowering the threshold to bring it in line with what was intended, but it is that high threshold figure that reassured students to take on very large 'headline' debts. If ensuring that students are not put off were a priority, other ways could be found to increase and bring forward repayments. For example, the minimum repayment could be increased from 9 per cent for incomes over the upper threshold.

If the repayment threshold is to be lowered, how should that be done? Freezing the threshold for five years would be to repeat the mistake made in 2010; this time by trying to disguise the real reduction in the threshold resulting from the freeze, last time by setting the threshold in nominal terms and flattering it by comparing with the

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<sup>34</sup> 'One of the most progressive features of these proposals is the fact that the repayment threshold, which is currently £15,000 will increase to £21,000'. Minister for Universities and Science, David Willetts, House of Commons, 3 November 2010.



nominal threshold six years earlier<sup>35</sup>. If retrospective changes are avoided, this would mean that the effect of the freeze will depend on forecasts of inflation and real earnings up to 2025. This is introducing an unnecessary level of uncertainty for both government and prospective students. The proposals cover the risks for government by proposing a review at the end of the freeze, which means that students would have no idea as to how their repayments would be calculated with up to 25 years of repaying to go.

The new borrowers should be given definite terms, which should apply for the whole repayment period. To reduce the uncertainty the threshold levels, both for repayment and maximum interest, could be set in terms of a percentage of average earnings. The longer term uncertainties, mainly due to the difficulty in estimating borrowers' earnings relative to average earnings over a long period, should be borne by government. The sales pitch for student loans confidently predicts a large and continuing 'graduate premium'; if this is accurate then the risks to public finances are not great. Students are less well placed as each individual student cannot be sure of being amongst those successful graduates who go on to get a well paid job.

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<sup>35</sup> The UUK Panel (UUK, 2015a, page 68) favoured the freezing of the repayment and maximum interest thresholds. They argued that this option 'retained the strongly progressive features of the current system'. This is somewhat curious given the same report pointed out that the absolute and relative increase in annual repayments from freezing the thresholds is largest for lower earners (page 56). They give no justification for the stealth rather than explicit approach to reducing the thresholds.

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