Dearing 25 years on: Successes, failures and lessons to be learned from other countries with ICLs

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Dearing terms of reference:

- To make recommendations on how the purposes, shape, structure, size and funding of higher education, including support for students, should develop to meet the needs of the United Kingdom over the next 20 years, recognising that higher education embraces teaching, learning, scholarship and research.

The Committee should have regard, within the constraints of the Government's other spending priorities and affordability, to the following principles:

- there should be maximum participation in initial higher education by young and mature students and in lifetime learning by adults, having regard to the needs of individuals, the nation and the future labour market;
- students should be able to choose between a diverse range of courses, institutions, modes and locations of study;
- **standards of degrees and other higher education qualifications should be at least maintained, and assured;**
- the effectiveness of teaching and learning should be enhanced;
- learning should be increasingly responsive to employment needs and include the development of general skills, widely valued in employment;
- higher education's contribution to basic, strategic and applied research should be maintained and enhanced, particularly in subjects where UK research has attained international standards of excellence or in Technology Foresight priority areas;
- **arrangements for student support should be fair and transparent, and support the principles above;**
- higher education should be able to recruit, retain and motivate staff of the appropriate calibre;
- value for money and cost-effectiveness should be obtained in the use of resources.

Reflections on Dearing’s objectives

- 25 years after the Dearing report – have its objectives been achieved?
- Gill and Anna will reflect on Dearing’s success in regard to students.
- Dearing also had as a key objective: increasing funding per student for universities whilst making it affordable for the taxpayer (ensuring quality of provision)
- Part of the carrot for universities supporting the Dearing reforms was a guarantee of more funding per pupil
- Part of the rationale was also increasing funded places at universities with future graduates contributing to the cost of this expansion and funding per pupil
- Reforms saw increases in funding per undergraduate degree up until 2016/17

Introducing fees with ICLs was the crucial element in achieving these objectives

- Dearing recommended fees be introduced for everyone with a universal income-contingent loans (ICL) to cover the cost of fees
- He also recommended means-tested grants be available to the poorest students
- He also recommended universally available ICL for maintenance in addition to means-tested grants (if there was modest real interest rate)

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  Not followed – means tested upfront fees up to £1000 introduced but eventually Dearing's recommendations followed in 2006 reforms when fees increased to £3000

- He also recommended means-tested grants be available to the poorest students

  Not followed but government re-introduced grants in 2005 but abolished again in 2016

- He also recommended universally available ICL for maintenance in addition to means-tested grants (if there was modest real interest rate)

  Partially followed but not in transparent way Dearing envisaged

What about interest rate on loans?

Dearing report said:

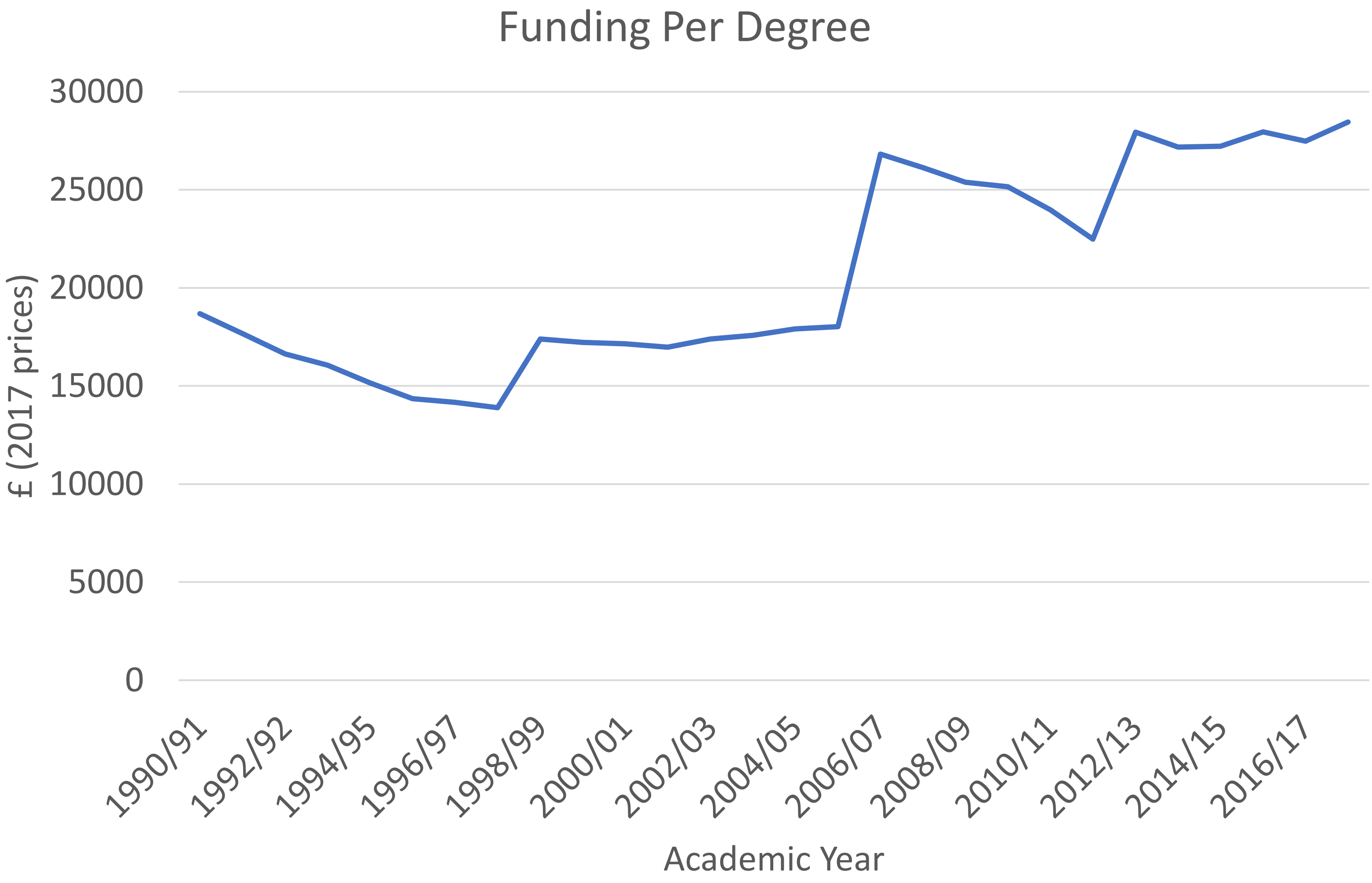
“Given the need to release substantial resources in the short term, ...we believe that the Government should structure any new arrangements for contributions to tuition costs so as to maximise the proportion of students who pay in advance rather than taking up a loan. Means testing the access to the loan or introducing a real interest rate would increase this proportion without additional incentives being offered. If neither of these options is pursued, we believe that there is a strong case for the introduction of a discount along the lines of the Australian model. Further detailed work would be necessary to determine the appropriate level of discount and ensure that the arrangements provided value for money over the longer term, as well as releasing additional funds in the short term.”

I am going to reflect on a few points

- Funding per degree falling before reforms and this was a key issue Dearing wanted to tackle

- Did it work?

Impact on undergraduate funding per student? (£2017)



But declines since then

- Fees frozen so recent large increase in inflation having large impact on real funding per degree

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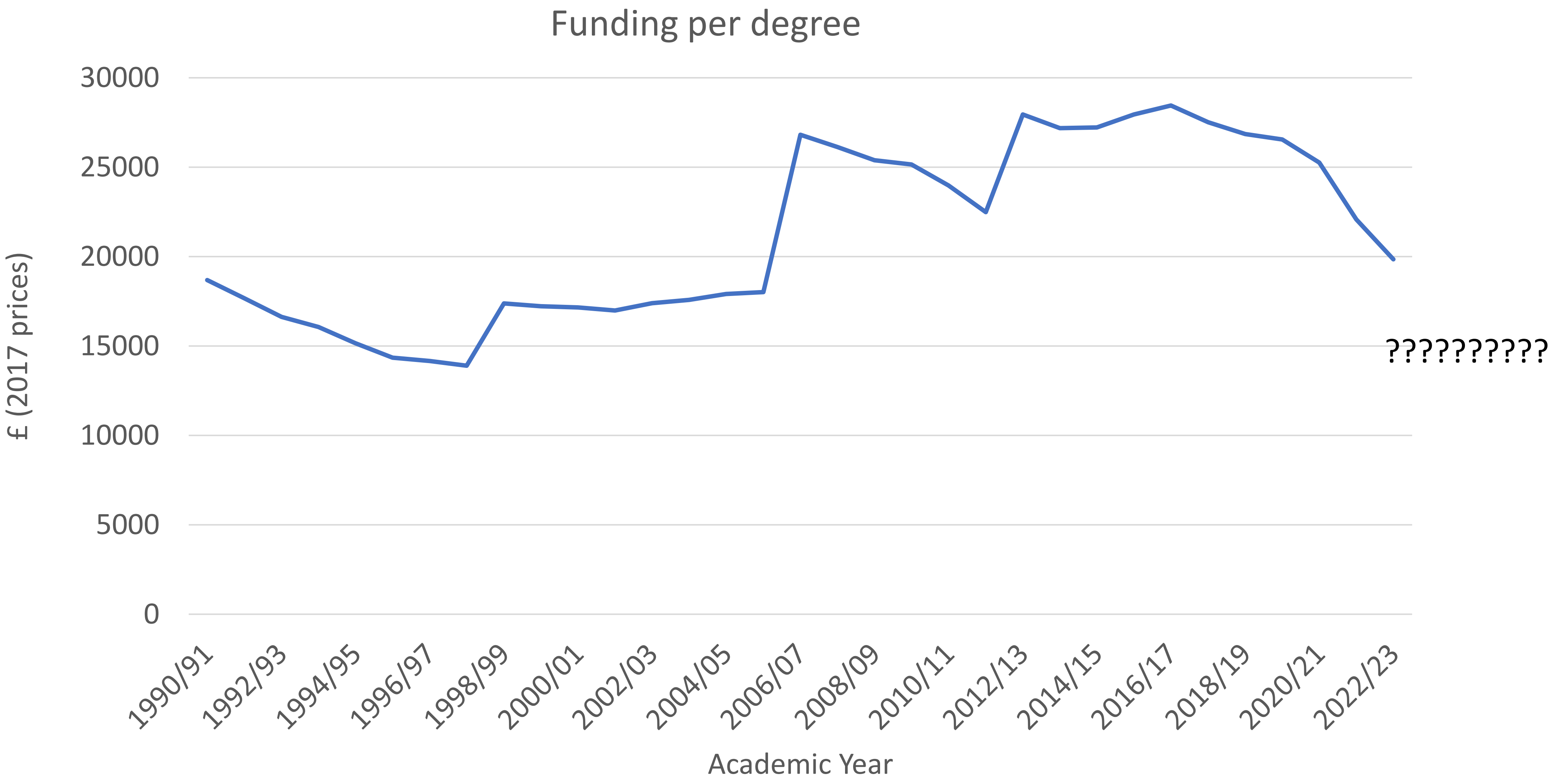

And this will continue with latest reforms for both existing and future students

- Freezing of fees up to and including 2024/25 then only increase with inflation – so further significant real cuts in university funding until 2024/25
- Moreover only students to benefit from the freeze in fees are highest earning graduates
- Repayment thresholds frozen at £25,000 in nominal terms and will impact on middle earning graduates most
- Further cuts in student support will impact on poorest students and likely to impact on participation of those from poorest backgrounds
  - This likely to reverse trends whereby biggest increase in participation from poorest students

Taxpayer burden of HE financing

- The government pays upfront around £21bn per cohort of individuals attending HE for around 425,000 English domiciled FT undergraduate students studying in the UK
  - Covers payment to universities (largely tuition fee payments funded by government student loans, but also teaching grants) and to students towards their living costs.
- However, because graduates later pay back loans for fees and maintenance via ICL, the long-run cost is somewhat different
- So LR taxpayer costs involve teaching grants to universities (predictable) and the LR cost of student loans (unpredictable)
  - = upfront cost minus the 'discounted' repayment of loans the government receives
  - Estimates sensitive to earnings growth assumptions and the discount rate used
  - RAB is the estimated proportion of loans that will not be repaid

Complicated and not transparent…

- Government does not publish its model (use to)
- Estimates of RAB very sensitive to assumptions
- Old accounting rules major reason for abolition of grants as they counted directly as part of government spending cf loans that didn't
- Rectified by OBR in 2018 which now treats estimates of the unpaid loan as government spending
- But this change didn't prompt the return of grants despite Auger Report advocating their return
    - Means poorest students have the largest loans
- Excellent report by IFS on this hugely complicated system:
- https://ifs.org.uk/education-spending/higher-education

Recent reforms – good or bad?
2022 reforms

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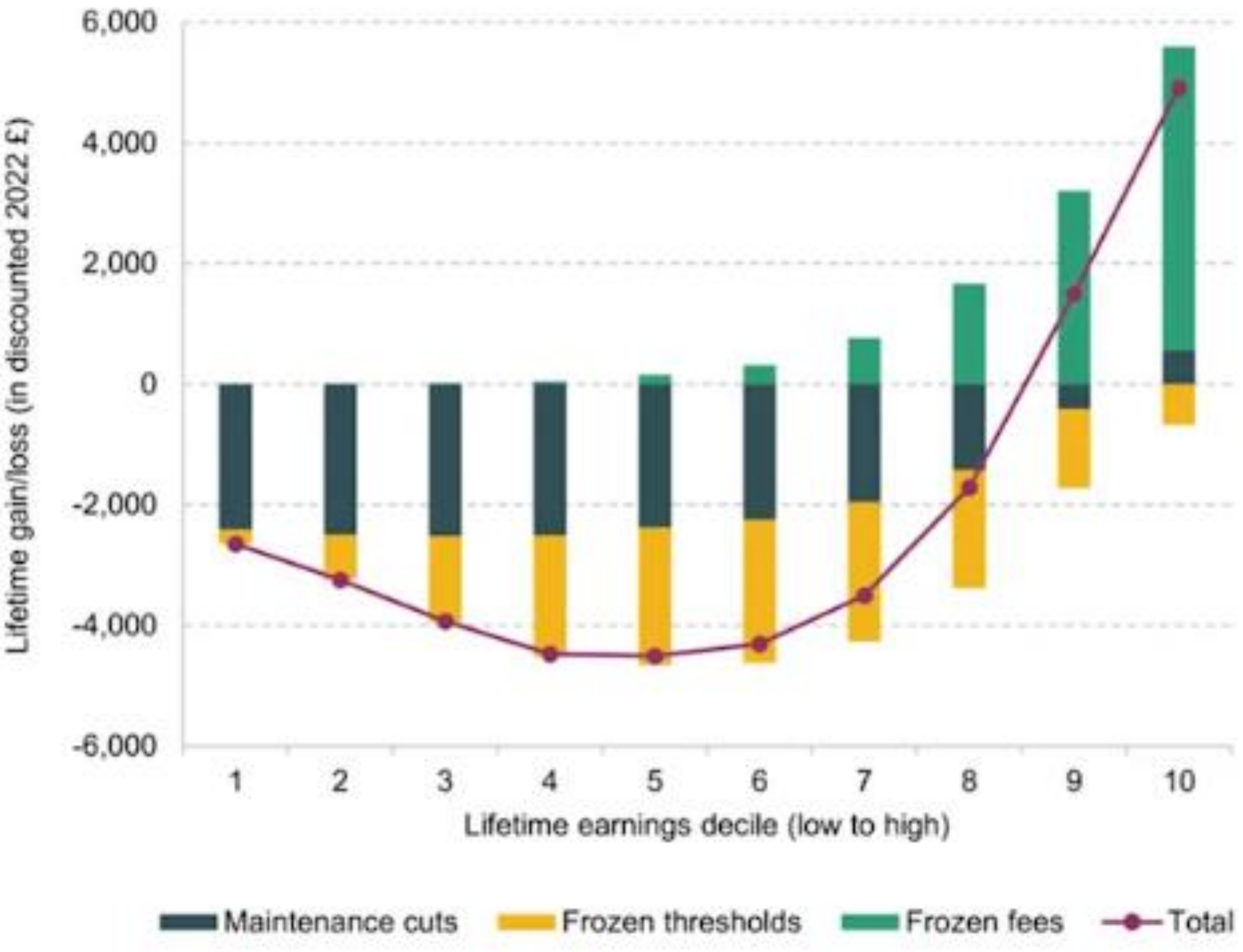
Figure 1. Impact on student loan borrowers by lifetime earnings decile (2022 entrants)



Graph: Institute of Fiscal Studies

2022 cohort

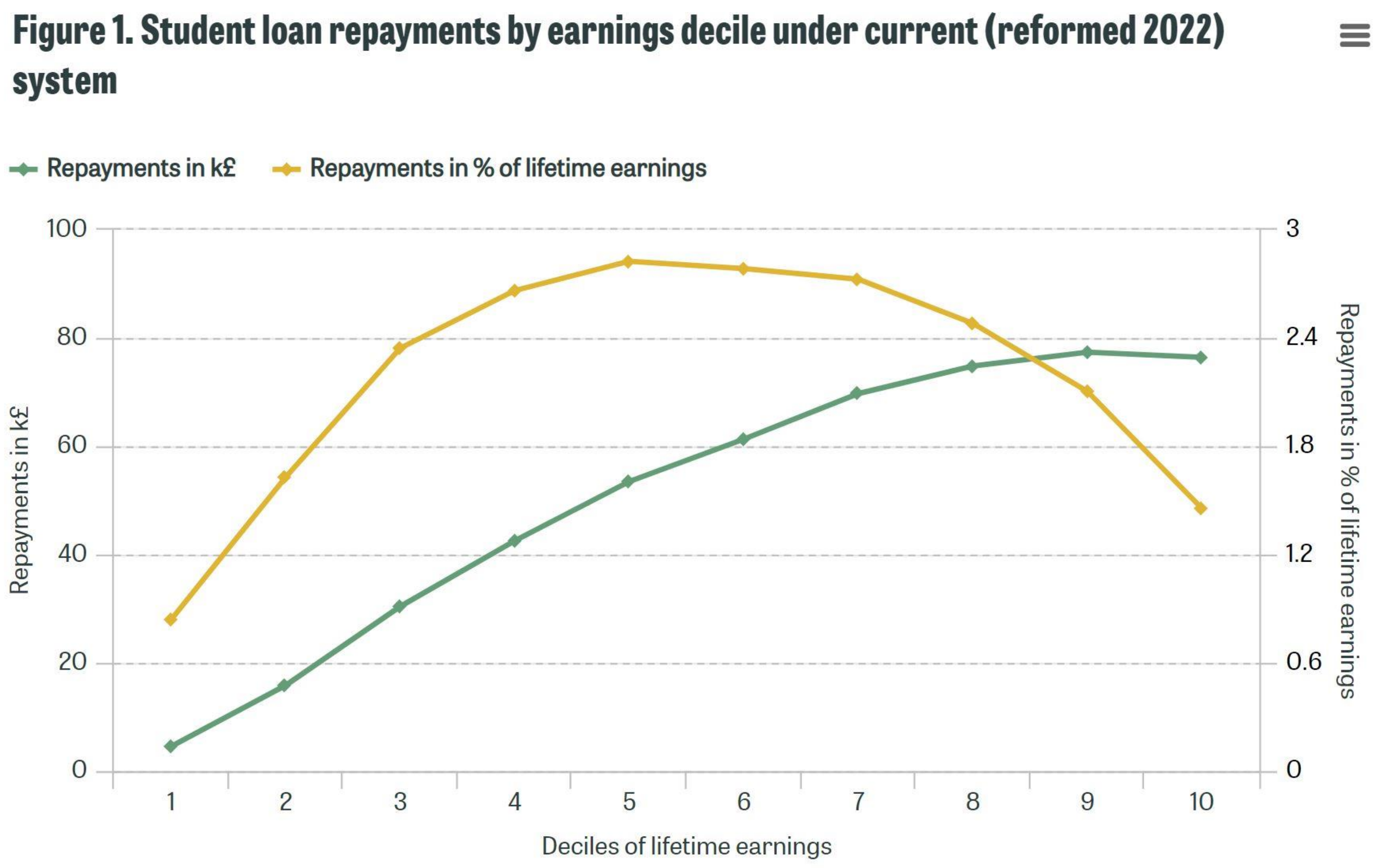
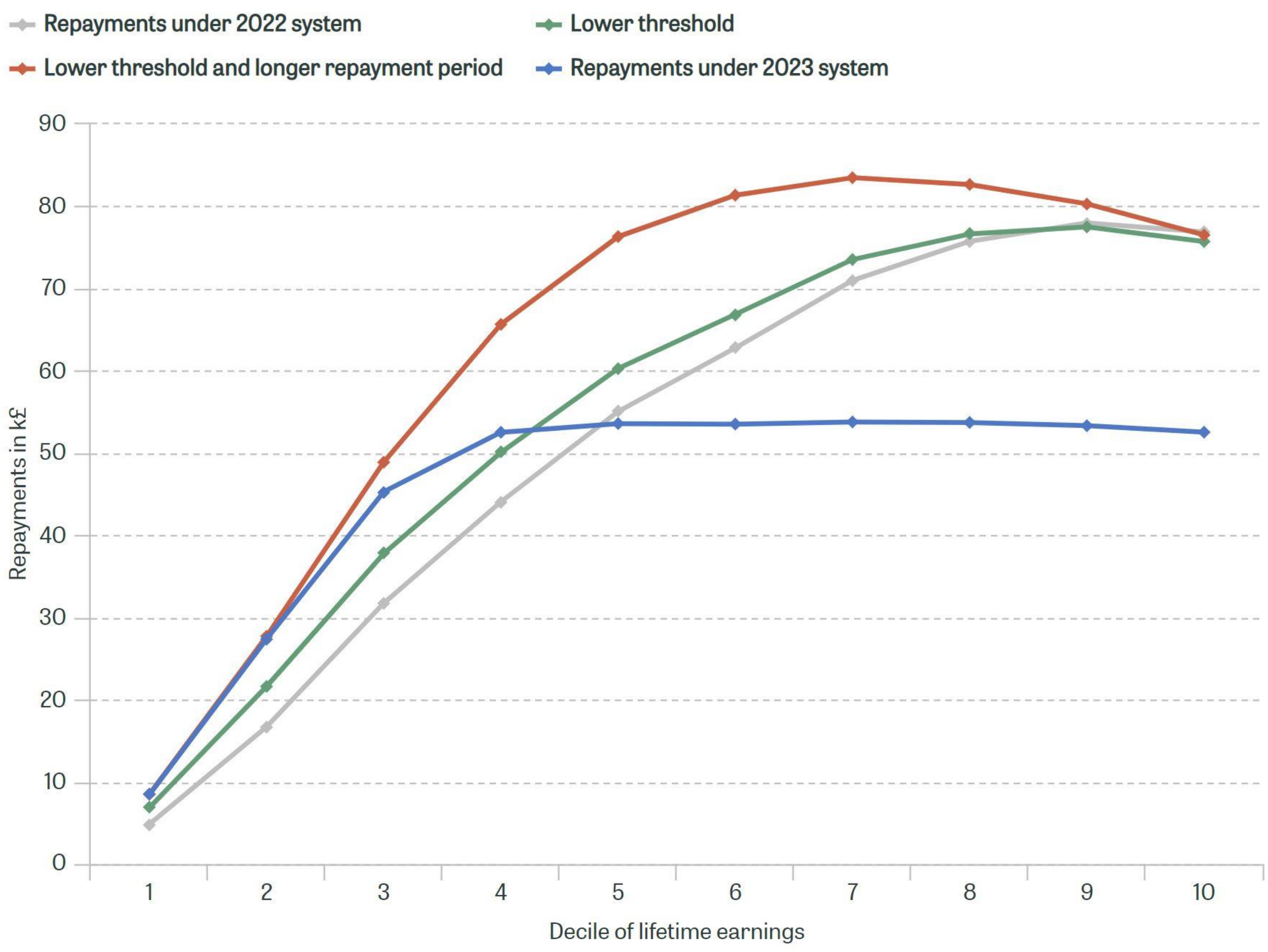


Figure 1. Student loan repayments by earnings decile under current (reformed 2022) system
Repayments in k£
Repayments in % of lifetime earnings
100
80
60
40
20
0
3
2.4
1.8
1.2
0.6
0
1
2
3
4
5
6
7
8
9
10
Deciles of lifetime earnings
Repayments in k£
Repayments in % of lifetime earnings

2023 reforms

- Repayment threshold will be lowered to £25,000 (compared with £27,295 for entry cohorts up to 2022) and frozen in nominal terms until 2027.
- The repayment period will be longer at 40 years, up from 30 years now.
- Interest rate on student loans will be the rate of RPI inflation
- Means student loans system moves from one where only a small minority of students go on to pay off their loans fully to one where most students will.
- Under the new system, student loans will become cheaper for high-earning graduates and more expensive for those with lower earnings (see Figure 2).
  - This is because the freeze in the repayment threshold and the extension of the repayment period will increase repayments for all borrowers except the highest earners. The cut in interest rates will counterbalance this effect, but only for the typically high-earning borrowers who pay off their loans in full.
  - Discount rate assumptions crucial for this finding….

Figure 2. Comparing the 2022 system and the 2023 system, 2023 entry cohort



What lessons can we learn from other countries?

- More progressive to have an upfront charge (same as fee discount) as anybody taking out loan will incur this, but only the richest graduates will bear the cost of this
  - Colombia is potentially doing this and Australia’s old fee discount was essentially the same idea – Dearing had this right
- Zero interest rate is problematic for maintenance loans as rich students can take loan and put in bank even if not needed
  - Should have some real interest linked to government cost of borrowing, certainly for maintenance loans – progressive.
- Having piecewise linear repayment rates and lower thresholds is a much better way of collecting ICLs (see Long EER 2019)
  - Colombia’s ICL is doing this
- Barr, Chapman, Dearden and Dynarski (2019) illustrate all these points

Some challenges for discussion

- Caps on student numbers being discussed again – good or bad?
- A lot of government policy, particularly 2012 reforms driven by bad economics – assumed that universities wouldn’t charge the maximum fee but they all did
- Vocational routes still largely left out of the picture – should have been part of the initial reforms in 1997 and still a long way from getting there
- Dearing basically had it right and still not fully followed….