

How should undergraduate degrees be funded? A collection of essays

Edited by Rose Stephenson



Higher Education Policy Institute

HEPI Report 173



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About the Editor

Rose Stephenson is the Director of Policy and Advocacy at the Higher Education Policy Institute. Rose directs HEPI's work on policy, including research, policy analysis and the development of policy recommendations. Rose is an experienced educator, having worked in outdoor education and as a teacher and Head of Science in secondary education before moving to the higher education sector. Rose worked at the University of Bath, overseeing policies and projects to improve the student experience. She is driven to support the development of considered, evidence-based policy and has an interest in social mobility and equity. Rose is a Governor of Hartpury University.

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Introduction

Rose Stephenson, Director of Policy and Advocacy,
Higher Education Policy Institute

The issue of a sustainable funding system for undergraduate degrees in UK higher education has been a hot topic for several years.

The £9,000 tuition fee in England was introduced in 2012 and in 2015, the Government announced that the tuition fee cap would rise with inflation for institutions who performed well under the Teaching Excellence Framework (TEF). In 2017, the fee cap was raised to £9,250. However, in October of 2017, it was announced that tuition fees would be temporarily frozen at £9,250.¹ The temporary freezing has, so far, been permanent. Unexpectedly high inflation rates mean that the £9,250 is now estimated to be worth around £6,000 in real terms.

Funding pressures in the devolved administrations mirror and often exceed those in England. For example, in Scotland, government funding has fallen by £2,325 per student in real terms between 2014/15 and 2021/22, and there was a funding gap of £4,000 to £7,000 per student in 2022/23, depending on the subject studied.²

Research by Public First has shown that there is little public support for increasing tuition fees. There is support for abolishing fees, but this drops dramatically when the cost to the taxpayer is outlined, or where there is a spending choice between tuition costs, the NHS or other parts of the education system.³

There seems to be little public or political will to change the current system; however, without change, the financial future of the higher education system is at risk.

Ahead of the upcoming general election, HEPI is focussing on the big higher education policy questions. To continue the debate on this topic, this HEPI report collates several potential funding scenarios for undergraduate higher education. This report hopes to breathe new life into this well-discussed debate. It brings together three key pieces of the puzzle: policy; economic impact; and applicant behaviour.

Why do we need to talk about funding for higher education?

PricewaterhouseCoopers (PwC) published a report in early 2024 entitled *The Financial Sustainability of the Higher Education Sector*.⁴ The report was commissioned by Universities UK (UUK). It sets out the systemic financial challenges that higher education institutions are facing because of structural constraints on their ability to generate income despite increasing costs. These structural constraints are features of the current funding regime that has been in place since 2013 when the domestic fee cap was first frozen in England. Over a decade later, PwC's analysis highlights the impact the funding regime has had on institutions' financial sustainability and the risks that have emerged as more institutions rely heavily on international fees to cross-subsidise domestic undergraduates and also delay much needed investment.

Key findings from the Universities UK and PricewaterhouseCoopers report included:

International fee income – The sector as a whole is anticipating further reliance on international student fee income – ranging between 33 to 66 per cent of all course fee income by 2026/27. As a result of this increased reliance, PwC's sensitivity analysis showed that a sharp reduction in international student income could result in 70 to 80 per cent of members falling into deficit within two years.

Operational expenditure growth – In England and Northern Ireland in particular, operational expenditure growth is assumed to fall below historic growth between 2020/21 and 2021/22, and notably below income growth projections. Given ongoing inflationary pressures and staff pay negotiations, this favourable assumption might be overly-optimistic, and would mean the financial position of institutions may end up being worse than forecast. Similarly, PwC's sensitivity analysis shows that an increase in the expenditure growth rate by just two percentage points could result in c.65 per cent of members falling into deficit within two years.

Capital expenditure – While the Scottish sector's forecasts are assuming a c.20 per cent year-on-year increase in capital expenditure, in England and Northern Ireland investment is assumed to fall significantly after the year 2022/23, with lower capital expenditure per FTE by the end of the forecast

period, than in 2020/21 for almost all types of institutions. This means that much needed investment is not yet being budgeted for.

Report author Kitty Kent, Associate Director at PwC, told us:

By its very nature, our aggregated analysis provides a view at a segment or national level. In practice, however, the impact of ongoing financial pressures, and of these sensitivities specifically, would not be felt evenly across the sector or within each segment. The sector is incredibly diverse and individual institutions will have varying degrees of risk exposure, and differing abilities to respond to such risks, or to absorb losses through existing cash reserves. The financial sustainability challenge is nonetheless undoubtedly systemic and is symptomatic of the current funding regime. The constraints on domestic undergraduate funding and the increasingly competitive research funding environment, mean that institutions are increasingly incentivised to recruit higher fee-paying postgraduates and international students. This increased pressure on margins results in tactical decisions to delay long term investment in favour of more immediate priorities, so it is no surprise that this is baked into regulatory forecasts.

Damien Ashford, Education Sector Lead Partner at PwC, added:

In the absence of system-level intervention in the near term, there are still a range of measures that institutions can take to bring about more sustainable operating models without impacting the student experience. Many institutions are already responding to the challenge, including in some cases through significant restructuring and transformation programmes, estates optimisation, strategic partnerships and income diversification. Once again, individual institutions will be at different points of this journey, with more or fewer levers still available to be pulled. What is clear is that institutions will need to continue to adapt to these pressures and to capitalise on opportunities to innovate their delivery models to ensure a sustainable future.

Institutions are already working to make efficiencies and to diversify funding streams in order to protect their financial sustainability. Institutions

need to act quickly and deeply. However, there are only so many efficiencies and improvements that can be made. As such, alternative funding models should be considered to protect the future of the UK higher education sector.

This report

This report contains introductory remarks by David Willetts, former Minister for Universities and Science (2010 to 2014) on 'what to do about university funding'.

This is followed by an outline of the baseline (current) funding scenario for England. Four proposals for alternative funding scenarios for England are then outlined by their authors. London Economics were commissioned by HEPI to model the costs of each baseline and suggested funding scenario in this report. Each scenario has been modelled to assess the resource implications of this versus the baseline system for:

- the Exchequer;
- higher education institutions; and
- students / graduates.

At the end of each chapter, a summary table of costs is included, alongside commentary on the economic implications. This information has been authored by London Economics, and additional information is available in the slide pack available on the HEPI website.

In addition, a summary of polling work, commissioned from UCAS, is included for each funding model.

The report then outlines the baseline (current) funding scenario for Scotland. Costs of the baseline model are detailed by London Economics, and polling data on how likely people are to apply to university under this model are summarised. This is followed by an alternative funding model for Scotland – with economic modelling and polling data added as above.

The report concludes with a chapter from Lily Bull, Policy Manager at the Russell Group, on the financial sustainability of higher education institutions.

Polling

To understand how different funding models might impact the behaviour of future students polling was delivered by UCAS for HEPI. This included polling potential applicants (those who had registered with the UCAS Hub and indicated they were interested in starting university or college in 2024, but had not yet applied for an undergraduate degree) and applicants (those who had submitted an application for an undergraduate degree in the 2024 application cycle).

The survey was completed by:

- 760 English domicile potential applicants
- 330 Scottish domicile potential applicants
- 1,695 English domicile applicants
- 370 Scottish domicile applicants

The results were weighted – and more information about the weighting methodology can be found in the accompanying slide pack.

One of the most striking findings from the polling results is how poor applicant and potential applicant understanding of student finance models is, including of the current funding model. Some respondents referred to this in a free text box at the end of the survey:

I think accessing information on tuition fee and maintenance loans is extremely difficult. I am a mature student and as such I need clear information on what I am able to get in maintenance loans as I have a household to support.

Not all students at sixth form fully understand the different types of payment for tuition fee[s] and so I don't think they'd be too swayed on which payment method they use.

Sometimes it can be confusing so it would be good to have guidance or it explained in an easier way.

This lack of understanding was perhaps demonstrated when the polling asked applicants / pre-applicants how likely they would be to apply for an undergraduate degree under the current funding model. Only 77 per cent

of applicants state that they either 'probably would' or 'definitely would' apply for an undergraduate degree under the current model – even though 100 per cent of these respondents had already applied under this exact funding system.

These results may have appeared for several reasons:

- 1) Applicants did not have a good understanding of the current funding system when they applied or did not realise that this question related to the current funding system.
- 2) Given that respondents could navigate back and forth in the survey, after seeing other models, they wanted to indicate that the current model was less favourable to them, compared to others.
- 3) Some applicants may not be planning to accept a place offered.
- 4) Respondents may be using their responses to attempt to influence change – responding with a potential behaviour, rather than what may be their actual behaviour.

Potential behaviour versus actual behaviour has been seen in relation to tuition fee changes previously. For example, an NUS / HSBC report in 2010 indicated that 'two thirds of students would be put off university by fees of £7,000'.⁵ There was a drop in applicants when fees were raised in 2012, however, this was much smaller than the polling suggested and application rates recovered within two years and have continued to increase over time since.⁶

As such, the polling in this report should be considered as an indication of predicted behaviour rather than a clear and unambiguous signal of actual future behaviour.

The questions in the survey offered simplified versions of the models described below. Despite this, the qualitative data demonstrated that some respondents struggled to understand these models, for example conflating the terms interest and inflation, or presuming that fees may change for them mid-course. This was a helpful reminder – to me at least – that these are complex concepts for many people to understand, particularly those who may not yet interact with these terms in other aspects of their lives.

The polling questions were also used to 'isolate' concepts. For example, abolishing tuition fees versus stepped repayments. As such, particular focus should be given to the question asked of respondents, which is stated at the end of each chapter.

A final note on polling: given the extent this was mentioned in the free text boxes in the polling, it is worth highlighting the experiences of Muslim students in relation to accessing funding for higher education:

As a Muslim British, so many of us cannot study for an undergraduate degree because of the interest we need to pay on the top of re-paying student loans and student maintenance. I have been waiting for many years now to study but unfortunately I am still waiting for a solution which will be adequate to my religion. I am happy to re-pay my student loan in the future but without an interest.

I am a Muslim. It is unlawful for us to get into debt, even if many do and the debt is stricken from the records at a later point.

I cannot take out a loan for university if I have to pay it back with interest. This is due to religious reasons.

As a Muslim, tuition fees are a huge concern.

The government has committed to introducing a student finance product with an alternative to interest payments. This will be known as 'alternative student finance' and will be compatible with Islamic finance principles. Alternative student finance will not be in place until after the launch of the new student finance system – the Lifelong Learning Entitlement – which will launch in 2025. There is no date stated for the launch of the alternative student finance system, only that it will be later than 2025.⁷ As such, this continues to be an area of higher education funding policy that needs close attention.

Fiscal policy

This report covers three important aspects needed for policy decisions in relation to undergraduate degree funding: innovative ideas; economic modelling; and polling of applicants. It does not, however, cover fiscal policy. Very simply, fiscal policy is the use of government spending and

taxation to influence the economy.⁸ It is clear that an increase in public spending is unlikely in the near future, and this should be considered when reading the economic modelling outcomes for each of the funding models proposed below.

Student number caps

Except for the Scottish baseline model discussed below, each model presumes that there are no student number caps being applied to the funding models. As such, the economic modelling outcomes will depend on the number of students undertaking undergraduate degrees. In models where students are supported by the state, an increase in student numbers would likely result in an increase in costs to the public purse. Discussions about student number caps are beyond the scope of this report and have been discussed elsewhere. However, the potential impact of increasing student numbers should be considered when reading the models outlined below.

What to do about university funding?

David Willetts, Minister for Universities and Science, 2010 to 2014 and author of *A University Education* (2017)

Our universities face a funding crisis. Fees of £9,250 are not sufficient to cover the costs of delivering higher education to the typical student. But many people, including many policymakers, do not believe this. They think it looks like quite a lot of money for modest contact hours and limited numbers of lectures. So, the first thing universities need to do is to be as transparent as possible about the costs they face.

Approximately £1,000 of the fee goes on mandatory access arrangements – this funds access and participation work in institutions. The other stages of education have separate capital grants from government, for example for building projects. However, I vividly remember the Treasury doctrine that tuition fees would have to cover the interest costs of borrowing that universities would need to fund any capital projects; so that is another use of the fee income. And although they are called ‘tuition’ fees they are really university fees covering everything from the cost of the sports facilities to burgeoning mental health facilities.⁹

Explaining these costs is the first step.

The next step is to explain that the Resource Accounting and Budgeting (RAB) charge – the rather speculative forecast of loan write-offs in 40 years’ time is not cash available to be spent today: there is no stash of money here to solve the sector’s financial problems. That then opens the question of what should be done about the system. There are calls for a new model of university funding. But they must engage with two basic truths of university funding.

First there is little political support for increased public funding of higher education – apart perhaps for bringing back some means-tested support, in the form of maintenance grants, and increases to the teaching grants for high-cost subjects, both of which would be a great help.

Even within the education sector, many colleagues favour increasing funding for other stages of education over higher education. I have been at education conferences where students outside call for free university

education while all the experts inside say we should prioritise early years. I happen to think this argument rests on exaggerated early years determinism and underestimates our capacity to learn and change later, but it is the conventional wisdom and completely cross-party – from Andrea Leadsom to Bridget Phillipson.

Secondly, graduates earn more than non-graduates. There are interesting arguments about why this is – signalling (that a degree acts as a sign to employees that a graduate has the level of skill and knowledge they are looking for), selection (that by being accepted to university, the graduate must hold some of the attributes the employer seeks) and investment in human capital (that the skills and knowledge gained during a degree makes graduates more employable than non-graduates). And there may be some decline in the graduate premium. But it remains the case that on average graduates earn more than non-graduates, so expecting graduates to pay back for their higher education is fairer and more progressive than expecting the generality of taxpayers to pay.

However, if students had to pay upfront, as many do in the US, then we might deter young people from going to university. Instead, we should fund them first and then expect them to pay back if and when they can afford to. This is a sensible midpoint between a full market model and getting back into public spending and taxation. It is the model we have had for over 20 years now and I see no better alternative. Indeed, it is quite delicately balanced to avoid the twin perils of either moving to a commercial system or public spending. If it were commercial and regulated as a financial service, then, for example, the 'know your customer' regulations would require assessment of individual creditworthiness and make it difficult to offer loans to students unlikely to pay back. If you break the individual payment model, then you lose the contract to deliver a service and are back with tax and public spending which condemns the sector to long-term decline and quite possibly further controls over borrowing and pay. I was often told universities were a public service and should be funded as such but the advocates of that were not so keen on the consequences of Treasury control.

A full-blown graduate tax would certainly bring higher education back

into tax and public spending. But that is not the only problem. It means what is says – you pay more tax because you are a graduate. I find that hard to defend – indeed a tax system which identifies a particular personal characteristic or attribute and then taxes your income is very unusual indeed for any liberal democracy. I can understand two people working side by side for the same pay but one having a deduction from some of her earnings as she is paying back for the cost of her university education. But I cannot understand such a deduction just because she is a graduate. That is not just wrong in principle it is also wrong in practice, especially as we now have clearer knowledge of courses and universities leading to higher earnings. Studying Economics or Law or Medicine at a prestigious university would mean a lifetime of higher tax payments way above the actual cost of your education. That creates a real incentive to study abroad. Suddenly American universities do not look so expensive.

The fees and loans model is therefore delicately positioned between two unpalatable alternatives of full commercialisation or entering the public sector. Extremes of the individual and the collective. It is a microcosm of so much British political economy balanced between the individual and the collective.

The criticism of many areas of public policy now is the endless churn of new policies. But the basic higher education model has not changed much for over 20 years. There is no alternative model to replace it. But the real problem with the current system is that it has got completely fossilised. I believe there should be a quinquennial review when all the variables in the system should be looked at to see if they should be reset in the light of economic changes.

There are some obvious issues to consider. What is the cost of delivering higher education? What is happening to average wages? What proportion of loans are being written-off? Should the repayment threshold be adjusted in the light of changing earnings or repayments? What is the right period for repayment – should it be a lifetime loan and a charge on the estate? Is 9 per cent the right rate? Could there be a raked set of rates, say 3 per cent, 7 per cent and 9 per cent but does that collect enough? Is it right to charge interest on the loan and if so, at what rate? And of course, do students have

enough to live on at university? Are cuts in their maintenance funding leading them to do so many hours of paid work that their studies are affected?

The quinquennial assessment should cover all graduates. That would help protect another flexibility in the system which is in danger of being lost. There is a misplaced fear that it would be retrospective to change the repayment terms of existing graduates. But it has always been made clear to students that there is the right to do so. And it is not a commercial fee or loan – many of which themselves are adjustable anyway. It is a graduate repayment scheme with terms set by government and adjustable by government. The advocates of a graduate tax do not envisage that the graduate tax rate is permanently set for each cohort of graduates as they leave university and, in this respect at least, they have a point.

The forthcoming general election presents a dilemma to both big political parties. They have to say something about higher education, but they do not want to nail their colours to any particular proposal now. A review of the calibration of the scheme is a way to avoid political traps now and give them maximum room for manoeuvre after the election.

Baseline scenario – The cost of the current undergraduate degree funding system in England

London Economics

Key points:

- Under the current system, tuition fees for full-time English domiciled students studying anywhere in the UK stand at £9,250.
- This is supported by tuition fee loans as well as access bursaries provided by universities themselves – not all students will pay back their fees in full.
- Maintenance loans are available. Full-time undergraduate students living away from their parents outside of London are eligible for a loan for the academic year 2023/24 between £4,651 to £9,978 per year, depending on household income.¹⁰
- Teaching grants are awarded, from the public purse, for high-cost courses, at a total of £1.26 billion per cohort.
- There is also a cost to the public purse for the write-off of unpaid tuition and maintenance loans. This costs £749 million per cohort.
- There are no student number caps in place in England.

The cost to the public purse

Under the current funding system for England in 2023/24, the public purse contributes approximately £2.01 billion per cohort of English domiciled students (£1.99 billion from the Westminster Government and £17 million from higher education funding bodies in the rest of the UK).

Within this total, maintenance loan write-offs cost the public purse approximately £326 million per cohort, while fee loan write-offs cost £423 million. The cost associated with the provision of teaching grants (for higher cost courses) to higher education institutions stands at £1.26 billion per cohort, including £1.24 billion for English higher education institutions (allocated by the Office for Students) and £17 million for Welsh higher education institutions (allocated by the Higher Education Funding Council for Wales).

The income for institutions

Higher education institutions receive £12.45 billion in net income per cohort, including £11.30 billion in fees and the above £1.26 billion in teaching grants. Against this income, higher education institutions contribute £108 million per cohort in fee and maintenance bursaries.

The cost to students

The average debt on graduation per student in the cohort (for full-time first-degree students studying in England) is estimated at £50,500, with average lifetime repayments of £53,800 and £42,100 for male and female graduates, respectively.ⁱ

Table 1

Resource flows (£ / £m / %)	Baseline scenario
Net Exchequer cost (adjusted for RAB)	
Cost of maintenance loans	(£326m)
Cost of tuition fee loans	(£423m)
Cost of teaching grants	(£1,257m)
Total	(£2,006m)
RAB charge (%)	4.1%
Net income (for UK higher education institutions)	
Gross fee income	£11,302m
Teaching grant income	£1,257m
Cost of bursary provision	(£108m)
Total	£12,451m
The cost to the student	
Average debt on graduation	£50,500
Average lifetime repayments (M / F)	£53,800 / £42,100

Negative values = Expenditure

Positive values = Income

ⁱ Debt on graduation and expected lifetime repayments per student are presented for full-time first-degree English domiciled students studying in England; in the baseline (current) funding system – as well as in Scenarios 1, 3, and 4 – the estimated debt on graduation and repayments for students studying in the rest of the UK are the same as for students studying in England.

The Resource Accounting and Budget (RAB) charge (the estimated cost to government of borrowing to support the student finance system) associated with the cohort is estimated at 4.1 per cent.

These costs are summarised in Table 1. A similar table is included for each of the proposed funding scenarios in this report, with comparisons to the baseline scenarios for England / Scotland as appropriate.

Potential applicant and applicant polling of the English baseline scenario – summarised by Rose Stephenson

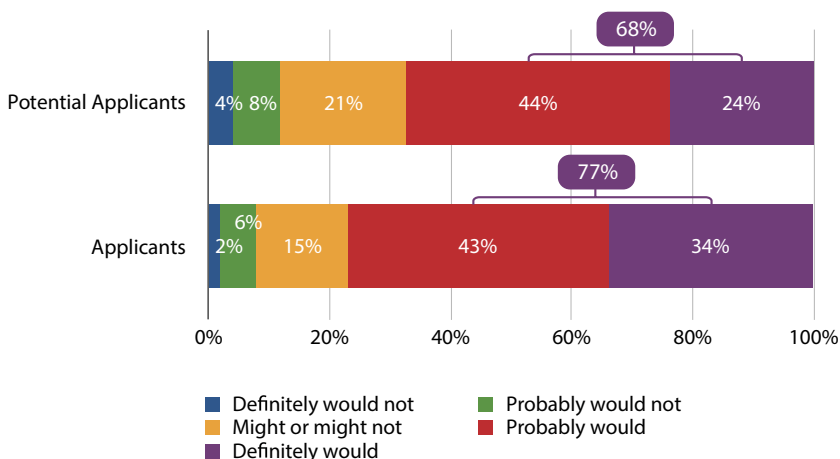
For the baseline funding scenario in England, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *Tuition fees cost £9,250 per year and you can access a tuition fee loan to pay for this.*
- *Maintenance loans are available.*
- *You will re-pay your tuition fee loan and maintenance loan as follows:*
 - *You will repay at a rate of 9% on everything you earn over £25,000 per year.*
 - *The debt will be wiped out after 40 years.*
 - *You will be charged interest on your loan.ⁱⁱ*

Based on the current funding model, 68 per cent of potential applicants and 77 per cent of applicants are likely to apply to complete an undergraduate degree at university. (Potential applicants are those registered with UCAS in this year's application cycle, but whom have not yet made an application, whereas applicants have made an application to complete an undergraduate degree).

ii In scenarios where a real interest rate is charged, this is described to respondents as 'you will be charged interest on your loan' In scenarios where interest is charged above the rate of real interest, it was explained to respondents as 'you will be charged a higher rate of interest on your loan'.

Figure 1: Likelihood of applying to complete an undergraduate degree at a university



These data will form the baseline from which to compare the alternative funding scenarios for England described in this report.

In addition to the findings above, 19 per cent of applicants and 15 per cent of potential applicants state that this funding model would affect their choice of university. The cost-of-living, and a wariness of building up 'debt', were both factors that respondents refer to. Respondents stated:

In an attempt to also reduce loans needed for accommodation I would look for universities closer to home rather than further away.

I would choose a Uni with affordable accommodation.

I would go to a university with cheaper living costs (e.g. not a London university).

However, some respondents state that the cost would affect their university through a perception of value-for-money or future earnings potential. Some students note that the cost drives them to consider university as an investment:

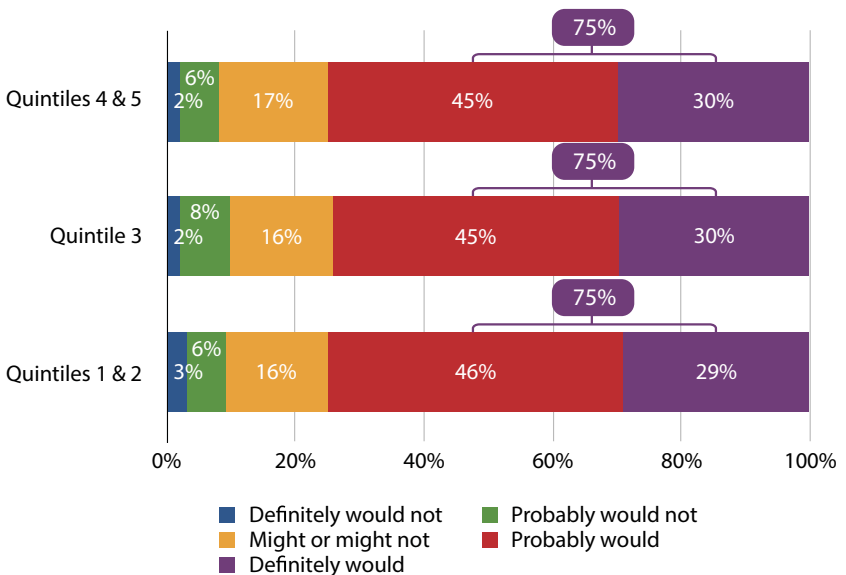
I would ensure I go to a good university instead getting a degree from a less renowned university.

I would like to increase my earning potential to pay back the loan by attending a better university.

If I am confident and able to afford study then I am [more] inclined to apply to more prestigious schools which may give an advantage when looking for employment after finishing my studies.

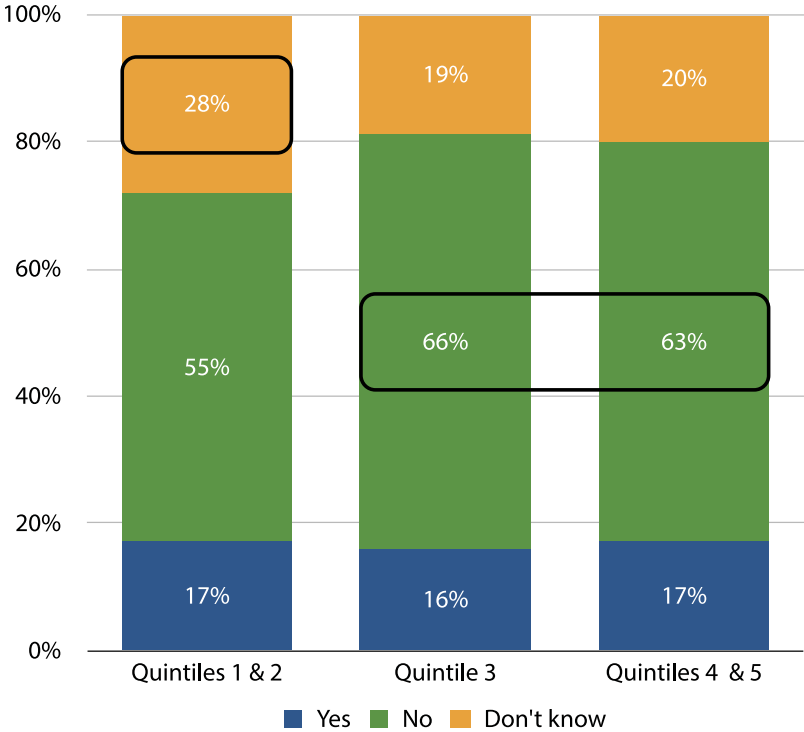
There is no difference in the likelihood of applying in the baseline funding model, for respondents from different POLAR4 quintiles. (POLAR4 classifies the proportion of the population who enter higher education from their geographical area. Those in quintile 1 are from areas with the lowest rates of higher education participation, while those in quintile 5 are from the areas with the highest rates of participation.)

Figure 2: Likelihood of applying to complete an undergraduate degree at a university - by quintile



However, more respondents from quintiles 1 and 2 are unsure whether this funding model would affect their choice of university, compared to respondents in quintiles 3, 4 and 5.

Figure 3: Would this funding model affect university choice? - by quintile



Scenario 1 – Dismantling the marketisation of higher education

Chloe Field, Vice President Higher Education at the NUS

Higher education is not just broken right now: it is heading into an existential crisis. The current funding model is being shown to be completely unsustainable on an institutional level and on a personal level for students.

Tuition fees are plunging hundreds of thousands of students a year into huge amounts of debt before some even have a chance to enter the workforce. Maintenance loans barely cover the spiralling costs of rent anymore, let alone to pay for food. Forget about having a social life, to even survive at university students must work long hours in precarious part-time jobs, affecting mental wellbeing and academic performance. In the NUS's latest research with students who work while they study, 38 per cent said it had a negative impact on their studies.

All these problems, despite being exacerbated by the recent cost-of-living crisis, are a direct consequence of the current higher education funding system. Universities rely on funding mostly from student fees which, in turn, rely on a consistent and large student intake each year.

Therefore, institutions' main priorities are making themselves look appealing to prospective students – and topping up their income with conferencing and summer lets – instead of focusing on the actual students studying currently. This means they must continue to expand their student numbers, leading to an even greater strain on resources and facilities – but with no additional money to alleviate that strain.

Running universities like businesses instead of establishments for educational growth and research leads to students being crammed into oversubscribed courses without the sufficient resources being there, such as the ideal number of lecturers or affordable accommodation.

So, what needs to happen? Tuition fees of course should be abolished, but they are simply a consequence of the current system: the root of this is all about competition that brings us a race to the bottom, rather

than incentivising comprehensive education and collaboration. Higher education needs to be publicly funded and in public ownership, not only to ensure access for all students from all backgrounds, but also to make sure every single community has a stake in their universities, and that they are run as truly civic institutions. We must invest in all areas of education and build a system that will ensure a future for my generation and for our planet.

It would of course be unreasonable to expect the next government to completely upend the system and create a new one overnight. However, it is important for political parties to take this crisis seriously and at least pledge to change the funding model completely. There are also steps that can be taken in the immediate future, such as the reintroduction of maintenance grants in England. NUS UK has commissioned research from London Economics that shows the return of maintenance grants could be funded by simple changes to loan repayments. By keeping higher earners in the system for longer, it means that the extra payments made by them go into the system to make the money available for grant financing of poorer students while they study. It is an easy cost-neutral step that any government elected in the next year can implement to begin lifting the debt burden on students and move towards a publicly-funded model.

Education is a devolved matter, so I want to be careful not to undermine the responsibilities and autonomy of devolved nations. Currently Scotland has no fees for home-domiciled students. However, what is holding their system back is the marketised model that is spread across the UK and the fact that non-Scottish students must pay fees. This means universities will prioritise the intake of fee-paying students over domiciled students. By breaking down that marketised model from a UK perspective, which includes removing fees for students studying in the UK, we then allow devolved governments to also do the same.

My proposal for a funding model for higher education, therefore, is in two stages:

- In the first instance, re-introducing maintenance grants, in addition to maintenance loans, to raise the total income for the worst-off students.
- Real interest rates of 3 per cent during study and 0 per cent to 5.5 per

cent for postgraduate earnings between £27,571 and £57,570 (and 5.5 per cent thereafter) on maintenance loans.

- A stepped maintenance loan repayment model:
 - 4 per cent on earnings between £12,570 and £27,570
 - 6 per cent on earnings between £27,571 and £57,570
 - 3 per cent on earnings over £57,571
- The repayment threshold will be updated with average earnings growth.
- The debt would be wiped after 31 years.

This model would apply to English students studying anywhere in the UK.

I would then propose that the next government makes a commitment to reviewing the funding model. I propose that abolishing tuition fees is crucial to this.

- Abolishing tuition fees for students. The cost of undergraduate education would instead be covered by non-repayable fee grants paid by government to universities. These would need to cover the true costs of education. For illustrative purposes, these would start at £9,250 and rise in line with inflation each year, to protect the unit of resource.
- Teaching grants for high-cost courses would continue to be paid by government, and these would rise in line with inflation each year, to ensure continued teaching quality. This has been modelled and polled in a bundle with reintroducing grant funding.

My generation has heard for our entire lives that there is not enough money for big ideas or to improve our chances. But as we see calls for cuts to inheritance tax and see a student loan repayment system that favours the wealthiest in our society, it feels like there is money available, but there is a government making a choice on who gets to benefit. Every government has this choice. We are asking the next government to choose young people, choose students and choose a future by investing in education.

The cost of Scenario 1 – by London Economics

Scenario 1 would result in a very substantial increase in the total Exchequer cost of the system of approximately £10.50 billion per cohort (524 per cent).

On the one hand, the Exchequer would save £423 million from the removal of fee loans and £2.34 billion due to higher maintenance loan repayments (due to the lower loan outlay, the stepped repayment system, and the (re-) introduction of real interest rates).

However, on the other hand, there would be large additional costs associated with the provision of fee grants (£11.60 billion), the re-introduction of maintenance grants (£1.62 billion) and the uprating of teaching grant funding with RPI going forward (£34 million).

Driven by the lower loan outlay and the changes to the repayment system, the RAB charge would decline by 29.5 percentage points, to -25.4 per cent. Hence, on average, graduates would repay more than their original loan outlay (in net present values in real terms), resulting in a negative RAB charge.ⁱⁱⁱ In other words, the (maintenance only) loan system here would generate a net surplus for the Exchequer.

Higher education institutions would benefit from an additional £443 million in net income per cohort. This includes an additional £301 million in gross fee income (driven by the uprating of tuition fees with RPI under Scenario 1, versus frozen fees under the baseline), £34 million in additional teaching grant funding (as teaching grants would also be uprated with RPI), and £108 million in savings as institutions would no longer be required to provide access bursaries to students.

The average debt on graduation (per full-time first-degree student studying in England) would decline by £27,800 (to £22,700), again due to the removal of fee loans. Average lifetime repayments would decline by £23,700 for male graduates and by £17,600 for female graduates.

iii 'Net present values' means that different streams of costs or income that are incurred at different points in time are presented on a common basis, in 'today's money terms'. Net present values are calculated using discount rates and based on people's time preference for money (for example, the concept that society prefers money now rather than later), so that any costs or income incurred further in the future are discounted at a higher rate (so are valued less in today's money terms).

Table 2

Resource flows (£ / £m / %)	Baseline	Scenario 1	Difference
Net Exchequer cost (adjusted for RAB)			
Cost of maintenance grants	-	(£1,624m)	(£1,624m)
Cost of maintenance loans	(£326m)	£2,010m	£2,336m
Cost of tuition fee grants	-	(£11,603m)	(£11,603m)
Cost of tuition fee loans	(£423m)	-	£423m
Cost of teaching grants	(£1,257m)	(£1,290m)	(£34m)
Total	(£2,006m)	(£12,508m)	(£10,502m)
RAB charge (%)	4.1%	-25.4%	-29.5 pp
Net income (for UK higher education institutions)			
Gross fee income	£11,302m	£11,603m	£301m
Teaching grant income	£1,257m	£1,290m	£34m
Cost of bursary provision	(£108m)	-	£108m
Total	£12,451m	£12,893m	£443m
The cost to the student			
Average debt on graduation	£50,500	£22,700	(£27,800)
Average lifetime repayments (M / F)	£53,800 / £42,100	£30,100 / £24,500	(£23,700) / (£17,600)

Potential applicant and applicant polling of Scenario 1 – summarised by Rose Stephenson

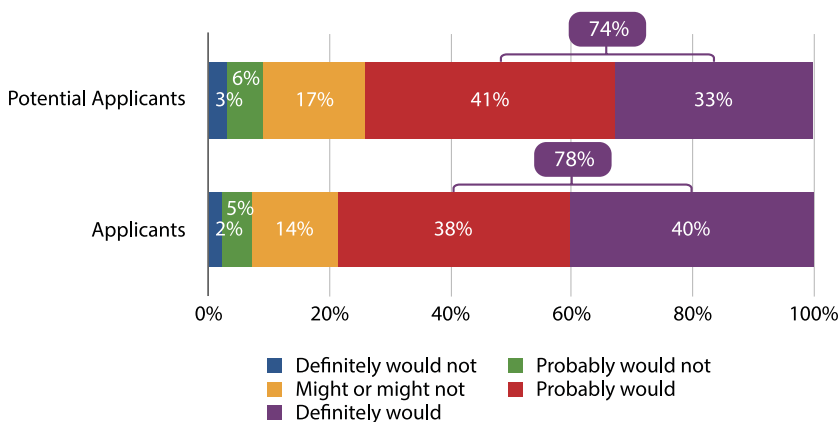
For Scenario 1, respondents were asked to state the likelihood they would apply to complete an undergraduate degree at university if:

- *Tuition fees are paid for by the government, and you won't be required to repay your tuition fees.*
- *Maintenance loans are available.*
- *Maintenance grants (which do not need to be repaid) will be available to students from lower-income households.*
- *You will re-pay your maintenance loan as follows:*

- You will repay at a rate of 9% on everything you earn over £25,000 per year.
- The debt will be wiped out after 40 years.
- You will be charged interest on your loan.^{iv}

Seventy-four per cent of potential applicants and 78 per cent of current applicants would apply to complete an undergraduate degree under this scenario. It is interesting that for current applicants, despite the removal of tuition fees and the reintroduction of maintenance grants, there is only a 1 percentage point increase in the applicant stating they are likely to apply, compared to the baseline model. It is a 6 percentage point increase for potential applicants.

Figure 4: Likelihood of applying to complete an undergraduate degree at a university



Thirteen per cent of potential applicants, and 11 per cent of applicants report that this model would affect their choice of university. (The baseline measures were 19 per cent of potential applicants and 15 per cent of applicants). This suggests that abolishing tuition fees may make some applicants feel that they have more choice over their chosen study destination.

^{iv} For polling that considers the stepped repayment model – see Scenario 3.

Respondents stated:

Right now, I feel like my choices for university are limited to universities close to me due to financial limitations but if the government were to pay for tuition fees then I would broaden my options and apply for universities like St Andrews or York.

Having a maintenance grant would allow for me to go to a uni in more expensive areas to live such as London.

I could aim for my first-choice uni with less worries.

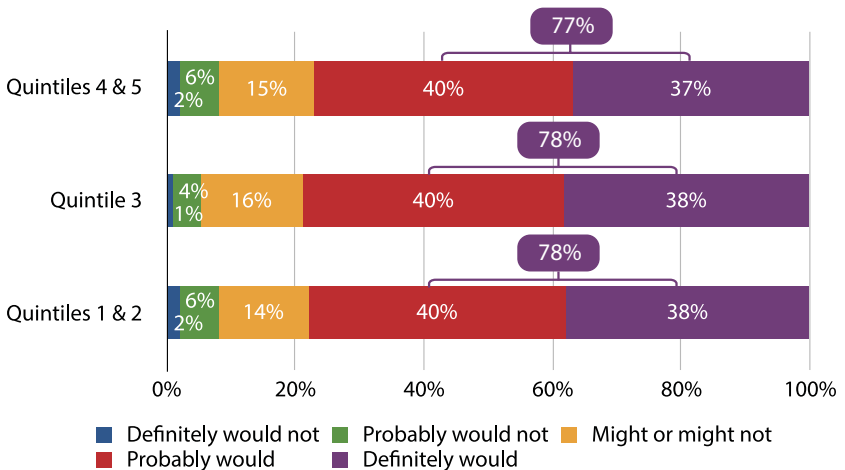
However, even with zero tuition fees, and maintenance grants available, respondents are still concerned about the cost-of-living, stating:

Again, I want to save on my student living cost like, travel, rent, food and would select universities close to home.

Would apply to a university in a more affordable city and that is easy to travel to so don't have student house to pay as well giving me less to pay back after university.

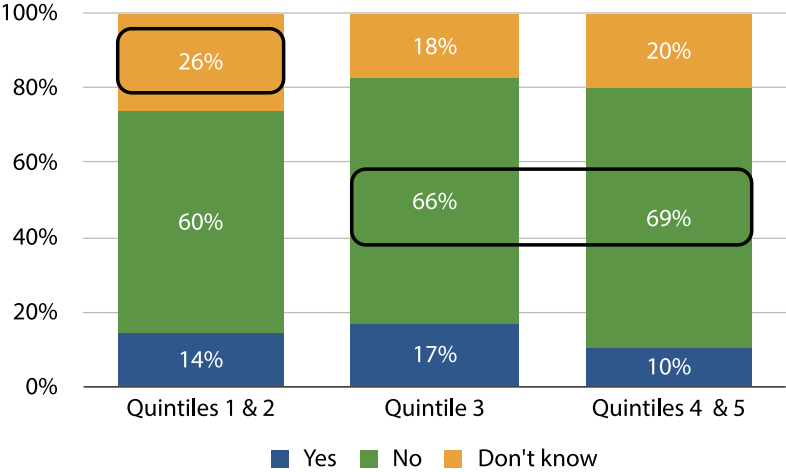
There is very little difference in the likelihood of applying in the baseline funding model, for respondents from different POLAR 4 quintiles.

Figure 5: Likelihood of applying to complete an undergraduate degree at a university - by quintile



Again, respondents from quintiles 1 and 2 were more likely to be unsure if this model would affect their choice of institution.

Figure 6: Would this funding model affect university choice - by quintile



Scenario 2 – Increasing tuition fees linked to an institution’s TEF award

Jo Johnson, former Minister of State for Universities and Science (2015), then Minister of State for Universities, Research and Innovation, 2016 to 2018

A good university funding system for England should have three primary goals:

1. provide sufficient financial resources to sustain a world-class higher education sector;
2. share the costs fairly between the general taxpayer and the individual student; and
3. remove the barriers that keep out the disadvantaged.

Measured against these objectives, the system Tony Blair introduced 25 years ago – a time-limited and income-contingent graduate contribution towards the repayment of heavily-subsidised loans – is the least bad option.

There is nothing wrong with the present funding model, except for two easily fixable flaws:

- first, the fact that the value of the fees is being eroded by inflation – the £9,250 fee is worth only £6,000 in 2012/13 prices
- secondly, there is currently no link between fees and the quality of the education on offer in a demand-led system that funds volume rather than outcomes.

The Cameron-majority Government, in which I was Universities and Science Minister, addressed these two flaws: institutions offering high-quality teaching and generating good student outcomes as assessed by the Teaching Excellence Framework would automatically be allowed to raise fees in line with inflation.

Institutions that came in the top two categories – Gold and Silver – were allowed the full inflationary uplift, as were those in the Bronze category, at least for the first iteration of the TEF, with the idea that in time they might be allowed only 50 per cent of it.

In July 2016, a month after Cameron had resigned following the Brexit referendum, I announced that fees for the 2017/18 academic year would rise by 2.8 per cent to £9,250.

This mechanism, sadly, was operational for one year only, as the new Prime Minister, Theresa May, called a snap election that shattered the Conservative majority upon which the policy depended. As the ensuing Confidence and Supply Agreement with the Democratic Unionist Party excluded student finance, so vanished chances of support for further inflationary uplifts.

At the time, its demise was unlamented.

First, no one much liked the accountability of the TEF and the sector, demonstrating its ability to miss the wood for the trees, had produced all manner of reasons to object to the methodology behind it.

And secondly, in a low inflation environment, an extra £250 did not really move the needle much financially either. Vice-chancellors could take it or leave it.

In hindsight, it is clear what a costly development this was. Inflationary uplifts through the TEF, had they continued these past six years, would have maintained university funding on a much more sustainable footing.

Gold and Silver rated providers would today be able to charge fees of around £12,200.

It would have meant a financial incentive of c.£43 million a year for a mid-sized university like York with around 15,000 first-degree students. Quite enough to make most vice-chancellors sit up and listen.

The University of East Anglia would have an extra £38 million a year coming in through domestic fees, enough to wipe out their forecast budget deficit.

Such a system, by linking funding to outcomes, aligns the interests of students, taxpayers and providers. It is clearly preferable to the three main alternatives:

1. Corbynist free tuition, which means 100 per cent taxpayer funding of university fees, and the inevitable return of student number controls to avoid unsustainable pressure on the public finances.

2. The de-funding of higher education, which is the result of the current somewhat Corbyn-lite Conservative policy of semi-permanently freezing fees at £9,250 and forcing the sector either to endure the relentless real terms erosion of the unit of resource or to accept student number controls as the price of maintaining the quality of teaching.
3. A graduate tax, with all the complexities it generates in avoidance, overpayment and the flight of talented students fearful of a lifelong levy to universities overseas.

The strongest argument against the first two systems – Corbynism and the current Corbyn-lite Conservative policy – is that both create immense pressure for the introduction of student number controls, a move that would throw the engine of widening participation into reverse gear.

One of the great advantages of our student finance system is that sharing the cost of higher education between the student and the Exchequer has enabled the Treasury to lift student number controls and allowed the widening of participation to drive both social mobility and productivity growth in the UK economy.

Reintroducing number controls is a policy that the UK might conceivably look at in 10 to 15 years' time, when more progress has been made in terms of narrowing the participation gap and when we have better evidence of other drivers of productivity growth than rising levels of educational attainment.

The participation gap is closing slowly, but in 2023 more than twice as many pupils in the most advantaged quintile progressed to higher education than those from the most disadvantaged quintile.¹¹

To slam on student number controls today would not just be a serious moral failure but also a huge brake on our productive capabilities as a country and the very antithesis of levelling up.

Meanwhile, the arguments against a graduate tax remain as strong as they were back in the 1990s when Tony Blair pushed back hard against them and in 2009 when the Browne review sensibly dismissed the idea.

The current system in England of income-contingent loan repayments is

similar to a graduate tax, but one which is capped at a fixed price (you do not repay more than you have borrowed in real terms) and time-limited (outstanding loans are written off by the Exchequer after 40 years).

It therefore has all the key benefits of a graduate tax – that students are not required to pay anything upfront and their contribution is linked to their earnings as graduates without the significant disadvantages that encourage students to engage in counterproductive avoidance behaviour.

Advocates of a graduate tax need to acknowledge that there are very few examples of the UK government ring-fencing future tax revenues for a specific purpose. Higher education institutions would be taking a very risky bet that future political leaders would remain committed to higher education and would hypothecate funds raised by the graduate tax to it.

It will never happen. Even if the funds raised from a graduate tax were somehow maintained within the Department for Education, Ministers would face the usual pressure to sort out problems of greater political salience in the mandatory part of the education system and allocate any available spare cash to early years, primary and secondary phases.

Finding a higher education funding system that protects both the student and taxpayer interest is not complicated.

We do not need a big review.

The mechanism to link funding to quality exists already in law in the Higher Education and Research Act 2017 (HERA).

One of its most important provisions allows fee caps to be set at differing levels based on a provider's TEF award, subject to overall limits prescribed by regulations scrutinised by Parliament.

We should make use of it.

Institutions that deliver great teaching and student outcomes, as assessed by the fourth iteration of the Teaching Excellence Framework, results of which have recently published, should be allowed to raise fees, prospectively, in line with annual inflation, starting ideally with effect from the academic year 2024/25: job done.

That would secure the three goals of a student finance system:

1. the unit of resource is protected without student number controls that constrain student choice and limit aspiration;
2. the financial burden is shared between the student and the taxpayer; and
3. barriers to access for disadvantaged students are removed.

Where the current model has clearly not worked to date is in promoting lifelong learning, which is in crisis.

The big policy question is how we today adapt this student finance model so it promotes lifelong learning not just first-time study by 18-year olds.

The planned creation of a Lifelong Learning Entitlement (LLE) represents a healthy shift of emphasis away from the dominance of the first-time learner in how we think of university funding.

The LLE is a huge opportunity to move to a more flexible funding system that funds credits rather than years of study – sadly, I fear it is one that we may be about to squander.

Ministers must grip this policy urgently if it is to be ready for delivery in the academic year 2025/26 and if it is to achieve the skills revolution they want.

There are four big problems with it at the moment:

The Government has signally failed to push universities towards accepting credits from each other, with the result that the vision of stacking learning into qualifications is as far away from becoming a reality as it ever has been. The autonomy of higher education institutions is an important and, rightly, a protected feature of our system but, in this respect, it needs to work in the student interest rather than just to protect revenues of institutions that fear losing learners.

The LLE needs to fund courses all the way from Level 3 to Level 7 rather than focusing on a limited set of qualifications at Levels 4 and 5. Totally excluding Level 7 courses, which are critically important for the upskilling of graduates already in the workplace, is absurd. Of course, loans for Master's courses programmes are already available through the Student

Loans Company but these lack the flexibility needed for modular funding, micro-credentials and learning over time.

The insistence on funding study that bears a minimum of 30 to 40 stackable credits – at a cost to the learner of £2,310 to £3,080 – will be a barrier to the reskilling and upskilling the policy is intended to promote. The Government need to allow learners to study for shorter courses, worth 10 to 15 credits, with smaller loans and a less onerous time commitment, if learners wish.

Most fundamentally of all, learners desiring specific skills do not necessarily want courses just derived from existing university qualifications. As Andreas Schleicher from the OECD put it in his excellent HEPI Lecture, individuals already in the workplace will want to pick from a wide range of micro-credentials, modules and short courses to shape a programme tailored to their specific needs, possibly spanning several disciplines and types of provider – this is surely what is needed, not more of the same university qualifications but in smaller pieces.¹² Higher education institutions have no monopoly on work-relevant educational material. It is a mistake for the LLE to entrench them as gatekeepers to lifelong learning.

Provided these three changes can be made to the design of the LLE, and provided we re-establish the link between funding and quality of provision, our system of income-contingent loans, which has now been around for a quarter of a century, will remain the least bad of all available funding systems.

The cost of Scenario 2 – by London Economics

Scenario 2 would result in a small increase in the Exchequer cost of the English funding system of £59 million per cohort (3 per cent) – all associated with English-domiciled students studying in England only (while fees for students studying in the rest of the UK would be unaffected). The increase is driven by a small increase in the cost of fee loan write-offs (£21 million) and maintenance loan write-offs (£38 million), with a marginal increase in the RAB charge (by 0.2 percentage points, to 4.3 per cent).

English higher education institutions would benefit from an additional £271 million in net income per cohort. This includes an additional £279 million in

gross fee income (driven by the increase in fees from 2024/25 onwards), partially offset against an £8 million increase in the cost of providing access bursaries to students (as we assume that bursaries would rise from 2024/25 onwards, alongside fees).

The average debt on graduation (again per full-time first-degree student studying in England) would increase by £800 (to £51,300). Average lifetime repayments would also rise marginally, by £800 for male graduates and by £500 for female graduates.

Table 3

Resource flows (£ / £m / %)	Baseline	Scenario 2	Difference
Net Exchequer cost (adjusted for RAB)			
Cost of maintenance loans	(£326m)	(£347m)	(£21m)
Cost of tuition fee loans	(£423m)	(£461m)	(£38m)
Cost of teaching grants	(£1,257m)	(£1,257m)	-
Total	(£2,006m)	(£2,064m)	(£59m)
RAB charge (%)	4.1%	4.3%	+0.2 pp
Net income (for UK higher education institutions)			
Gross fee income	£11,302m	£11,582m	£279m
Teaching grant income	£1,257m	£1,257m	-
Cost of bursary provision	(£108m)	(£116m)	(£8m)
Total	£12,451m	£12,722m	£271m
The cost to the student			
Average debt on graduation	£50,500	£51,300	£800
Average lifetime repayments (M / F)	£53,800 / £42,100	£54,600 / £42,600	£800 / £500

Potential applicant and applicant polling of Scenario 2 – summarised by Rose Stephenson

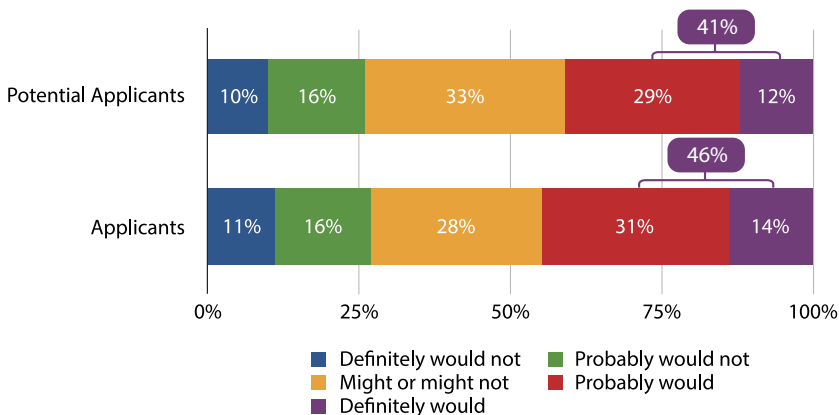
For Scenario 2, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *Tuition fees cost £9,250 per year and you can access a tuition fee loan to pay for this. However, tuition fees may be able to rise each year.*

- *Universities that gain a Gold or Silver award for the quality of their teaching will be able to increase their tuition fees each year in line with inflation. At the current rate, tuition fees would be:*
 - *£9,250 in 2024/25.*
 - *£9,814 in 2025/26.*
 - *£10,413 the following year.*
- *Universities that gain a Bronze award for the quality of their teaching will be able to increase their tuition fees each year in line with half the measure of inflation. At the current rate, these tuition fees would be:*
 - *£9,250 in 2024/25.*
 - *£9,532 in 2025/26.*
 - *£9,822 the following year.*
- *Universities that didn't gain a Gold, Silver, or Bronze award for their teaching quality would not be able to increase their tuition fees, which would remain at £9,250.*
- *Maintenance loans are available.*
- *You will re-pay your tuition fee loan and maintenance loan as follows:*
 - *You will repay at a rate of 9% on everything you earn over £25,000 per year.*
 - *The debt will be wiped out after 40 years.*
 - *You will be charged interest on your loan.*

There is a significant reduction in the percentage of both potential applicants and applicants who say they are likely to apply to university under this model. Forty-one per cent of potential applicants and 45 per cent of applicants say they would be likely to apply to university. (This compares to 74 per cent and 78 per cent seen in the baseline scenario.)

Figure 7: Likelihood of applying to complete an undergraduate degree at a university (figures may not sum due to rounding)



There is also an increase in the number of respondents that state this model would affect which institution they would apply to – 37 per cent of potential applicants and 39 per cent of applicants. When asked ‘in what way’ their application decisions would be affected, respondents stated:

I would be less inclined to go to a university that achieved a silver or gold in quality of teaching.

Better universities are more expensive so would be less motivated to aim for a top university.

Less qualified and poor teaching Universities would become more appealing.

If I wanted to go for a university with a gold, silver or bronze award, it would cost me more than one that does not. I would want to apply to a higher end university, but this factor might deter me from doing so.

Respondents also shared their broader thoughts on this model, including:

This model is an abomination that reinforces economic inequality, making it so only the wealthiest can attend prestigious universities. I'm not sure how it is even being considered.

Most of the comments reflected the idea of choosing a cheaper university to study – and this was the case across all POLAR4 quintiles. However, it is again important to note that polling of predicted behaviour often does not accurately align with actual behaviour.

There were also comments, although fewer in number, from respondents indicating that they would be motivated to choose an institution with a higher TEF rating. These included:

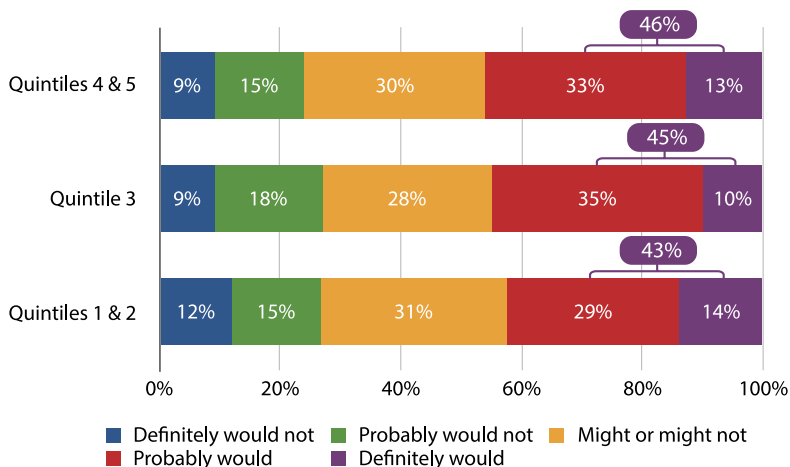
I would be interested in studying at a top university to guarantee a spot in employment after I graduate.

I would be more likely to apply to a silver or gold standard university even though I don't agree with that method of ranking.

If a university has a better teaching quality I am more inclined to choose that particular university because the education I will receive will be of a higher standard.

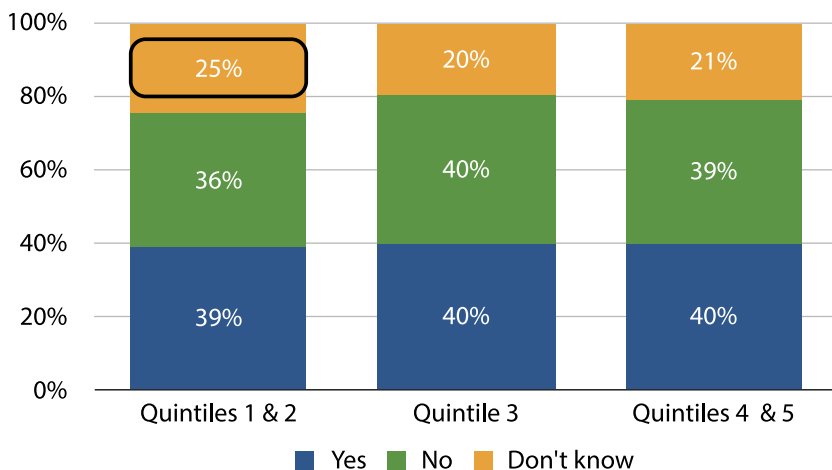
There is little difference between the POLAR4 quintile categorisation and the likelihood of applying.

Figure 8: Likelihood of applying to complete an undergraduate degree at a university - by quintile



Again, respondents in quintiles 1 and 2 are more likely to be unsure about whether this funding model would influence their choice of institution.

Figure 9: Would this funding model affect university choice - by quintile



Increasing tuition fees in England in line with inflation

Scenario 2 outlines the possibility of increasing tuition fees with inflation, linked to TEF outcomes. A similar model, which is regularly proposed, is simply to raise tuition fees in line with inflation. At a HEPI General Election Briefing held at the University of the Arts London in March 2024, Vivienne Stern, CEO of Universities UK, stated:

We've got to get rid of the idea that linking the tuition fee in England to inflation is raising the fee. It's not. It is stopping it going down ... I'm not arguing that we should put the burden of the fee on students up in the English system ... But we should stop it going down in real terms.

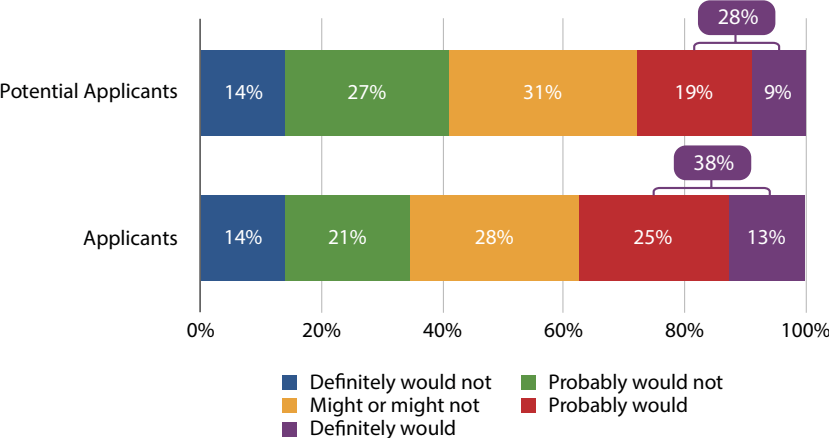
Given the regularity with which an inflationary increase in tuition fee is proposed, we added this question to the polling to see what the impact on applicant behaviour might be if the increased burden were passed on to students.

For a simple inflationary increase model, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *Tuition fees will cost £9,250 initially, and you can access a tuition fee loan to pay for this. This is the same as the current system.*
- *However, tuition fees will rise each year in line with inflation. At the current rate, tuition fees would be:*
 - *£9,250 in 2024/25.*
 - *£9,814.25 in 2025/26.*
 - *£10,413 the following year.*
- *Maintenance loans are available.*
- *You will re-pay your tuition fee loan and maintenance loan as follows:*
 - *You will repay at a rate of 9% on everything you earn over £25,000 per year.*
 - *The debt will be wiped out after 40 years.*
 - *You will be charged interest on your loan.*

There is a significant reduction in the percentage of both potential applicants and applicants likely to apply to university under this model. Twenty-eight per cent of potential applicants and 38 per cent of applicants would be likely to apply to university. (This compares to 74 per cent and 78 per cent seen in the baseline scenario.) These rates of 'likelihood to apply' are even lower, when tuition fees are simply increased with inflation, than when inflationary increases are linked to the TEF. This may be due to the lack of a 'cheaper option', which was seen as favourable by many respondents in Scenario 2. Alternatively, it could be that respondents are more willing to pay higher tuition fees if they believe this is linked to a higher value degree – one from an institution with a TEF Gold award.

Figure 10: Likelihood of applying to complete an undergraduate degree at a university



Scenario 3 – Fixing higher education funding should start with student loans

James Purnell, President and Vice-Chancellor of the University of the Arts,
London

University funding is not working. Funding for students' courses has been falling consistently for the past decade. By 2026, it will be at its lowest level for over 25 years. At the same time, demand for going to university is increasing. This is good. We need more university graduates. But if we are to give British employers the graduates they need – and aspirant young people the world-class education they deserve – higher education funding will need reform.

It is not the task of universities to fix a broken system. Nevertheless, we must have a voice. That is why I was very pleased to take part in a HEPI discussion on the future of higher education at the Conservative Party Conference in 2023. The whole system desperately needs reform to ensure the sector's long-term sustainability. But in the short-term, one area where I believe we can make a significant improvement is the student loan system.

In 2018, Theresa May commissioned a review into higher education, led by Sir Philip Augar. In response to Augar's recommendations, the Government announced new reforms in 2022. For students entering higher education from 2023/24 onwards, the threshold for loan repayments was lowered from £27,295 to £25,000, frozen until 2026/27 (inclusive) and uprated with inflation rather than average earnings growth. Real interest rates were removed and the length of time before student debt is written off was increased from 30 to 40 years. This has reduced the cost per university cohort to the Exchequer by £1.12 billion, or 36 per cent of the total.

In practice, however, the reforms mean the greatest burden falls on low- and middle-earning graduates. The better off, meanwhile, pay less, both in absolute terms and as a percentage of their income. The heaviest burden of all will fall on middle-earning graduates. All graduates on the fifth income decile will make higher repayments than their counterparts on the tenth income decile, with women in this decile the worst affected, paying approximately £30,000 more under the changes. Contrast this with a male graduate on the tenth income decile who will pay approximately £15,000

less. To put it bluntly, a nurse must now pay back more than a banker.

This is unfair and made worse by reforms to student maintenance. Maintenance grants were scrapped in 2016, and the maintenance loan that replaced them has not kept pace with inflation. The 2023 Student Money survey found the average monthly shortfall between maintenance loans and student living costs is £582.

In 2022, the University of the Arts London (UAL), where I serve as Vice-Chancellor, commissioned London Economics to model some alternatives to the student loan repayment system. One alternative option is to scrap the student loan system entirely and replace it with a real graduate tax (something that has been mooted by politicians in the past). A tax tied to income, which no wealthy graduate would be able to pay their way out of, would be genuinely progressive. According to our modelling, such a policy would also allow for the return of maintenance grants.

An option that would not require such a major overhaul of the system is the introduction of a stepped repayment system. This would not cost the Exchequer a penny more. In fact, it would save £841 million a cohort. This would allow for re-investment into other parts of the system – such as maintenance support and the unit of resource available to universities. Instead of the current marginal rate of 9 per cent, graduates would pay back their loan at a rate of either 3 per cent or 6 per cent. Real interest rates would increase from 0 per cent to between 0 to 3 per cent for those earning between £27,571 and £57,570, and to 3 per cent for those earning above £57,570. Finally, the repayment period would take place over 30 years, rather than the current 40 years. The system would mean higher earners would be obliged to make repayments for more of the maximum repayment period, which would subsidise a shortfall in repayments from low and middle-earning graduates.

Either a graduate tax or a stepped repayment system could be introduced while doing more to help current students dealing with pressures from the rising cost-of-living. Reinstating maintenance grants would help rebalance the debt burden, but students also need more financial support in the here and now. Student rents increased by 14.6 per cent, on average, between 2021/22 and 2023/24, with maintenance loans struggling to keep pace.¹³

These pressures are no doubt greater through the winter. While universities will do all they can for struggling students through advice and subsidies, there is a role for government too. Up-rating maintenance loans in line with inflation is something that can and should be done immediately.

As we approach a general election, the sector must decide where to focus its lobbying efforts. Should we argue for another cross-party review, or for short-term improvements to the system? If I had to choose, I would opt for the latter. That would involve, as suggested here, reforming student finance, up-rating student maintenance and reducing the loss universities make on home students and research. Augar's review took five years from launch to (partial) implementation. The system needs reform now.

The cost of Scenario 3 – by London Economics

While Scenarios 1 and 2 would result in an increase in the Exchequer cost associated with the English funding system, Scenario 3 would instead generate large Exchequer cost savings of approximately £841 million per cohort (42 per cent). In other words, the stepped repayment system here would free up £841 million of Exchequer resource per cohort for potential re-investment into other parts of the system (such as maintenance support or the unit of resource available to higher education providers – for example through teaching grant funding). The savings are driven by an increase in total fee and maintenance loan repayments made by graduates (increasing by £478 million and £363 million per cohort, respectively).

The RAB charge would decline by 4.6 percentage points, to -0.5 per cent. Hence, as under Scenario 1, the loan system would generate a net surplus for the Exchequer, though to a much smaller extent than the changes proposed under Scenario 1.

Higher education institutions would be unaffected by the changes.

The average debt on graduation (per full-time first-degree student studying in England) would increase by £1,600 (to £52,100), driven by the (re-)introduction of real interest rates during study. Average lifetime repayments would increase by £10,000 for male graduates but decline by £3,200 for female graduates.

Table 4

Resource flows (£ / £m / %)	Baseline	Scenario 3	Difference
Net Exchequer cost (adjusted for RAB)			
Cost of maintenance loans	(£326m)	£37m	£363m
Cost of tuition fee loans	(£423m)	£55m	£478m
Cost of teaching grants	(£1,257m)	(£1,257m)	-
Total	(£2,006m)	(£1,165m)	£841m
RAB charge (%)	4.1%	-0.5%	-4.6 pp
Net income (for UK higher education institutions)			
Gross fee income	£11,302m	£11,302m	-
Teaching grant income	£1,257m	£1,257m	-
Cost of bursary provision	(£108m)	(£108m)	-
Total	£12,451m	£12,451m	-
The cost to the student			
Average debt on graduation	£50,500	£52,100	£1,600
Average lifetime repayments (M / F)	£53,800 / £42,100	£63,800 / £38,900	£10,000 / (£3,200)

Potential applicant and applicant polling of Scenario 3 – summarised by Rose Stephenson

For Scenario 3, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

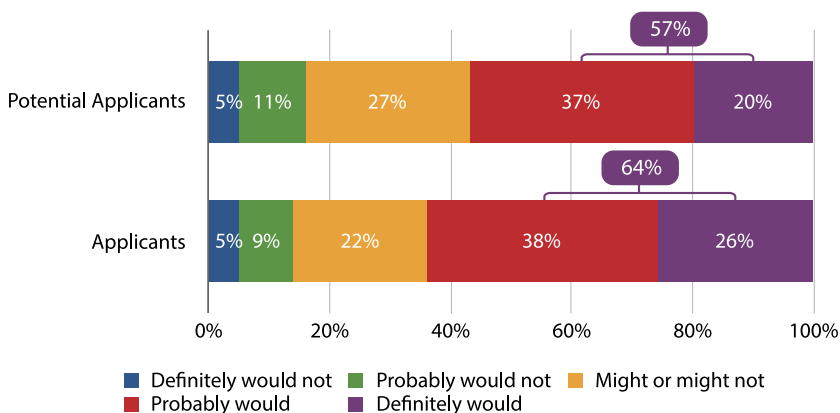
- *Tuition fees cost £9,250 per year and you can access a tuition fee loan to pay for this.*
- *Maintenance grants (which do not need to be repaid) will be available to students from lower-income households.*
- *Maintenance loans are available.*
- *How you repay your loans will differ. Under the current system, higher earners pay off their loans more quickly and therefore end up paying less overall. In this model, even the highest-earning graduates continue making repayments until the end of the repayment period. The increased*

repayments of the highest earning graduates therefore subsidise the lower / middle-income graduates.

- The debt will be wiped out after 31 years.
- You will be charged a higher rate of interest on your loan.

Compared to the baseline model, there is a reduction in likelihood of both the potential applicant (57 per cent) and applicant respondents (64 per cent) applying to university, down from 68 per cent and 77 per cent respectively, seen in the baseline.

Figure 11: Likelihood of applying to complete an undergraduate degree at a university



However, only 9 per cent of potential applicants and 6 per cent of applicants stated that this model would impact their choice of university, compared to the 19 per cent and 15 per cent in the baseline scenario. When asked 'in what way' this model would affect their choice, respondents stated:

With a maintenance grant I'd have fewer limitations.

I would be more confident in applying to any uni rather than limit myself to locals.

It would give me more freedom to pick a university and choose to go to university.

There were a few comments that suggested a resistance to a progressive model of repayment:

I want to work hard to become a high-level income worker, but with this model, I might as well not go to university and settle for a low paying job.

You are penalising someone who is able to pay it off early just because others can't. If they work hard to earn more why should they be locked in to paying loads of interest over many years at a higher rate.

And some support:

I believe this has been the best model so far. This will make students from lower / middle class families feel more equal to their higher income and more fortunate classmates. I would feel the freedom to apply to any university I wanted [if] I knew I was on equal grounds with others when it comes to repaying loans.

Respondents appeared nervous about the increase in interest rates mentioned in this scenario. This was also reflected in the free text responses of other scenarios, although not to the same extent. This may explain the reduction in likelihood that respondents would apply to university. Respondents stated:

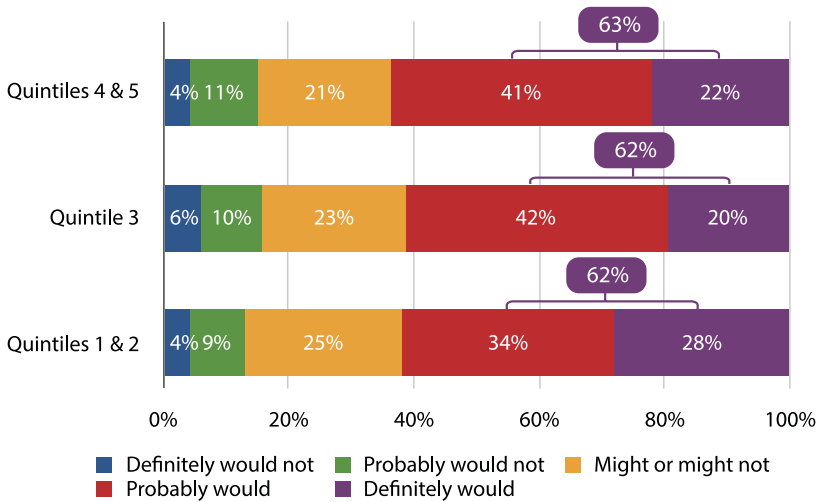
Because I will be charged interest.

Unsure about exactly how this works and how high the 'higher rate of interest on your loan' is. Does this contribute to lowering the amount for 'lower / middle-income graduates'?

Even higher interest rates? During an economic crisis? You have to be kidding me...

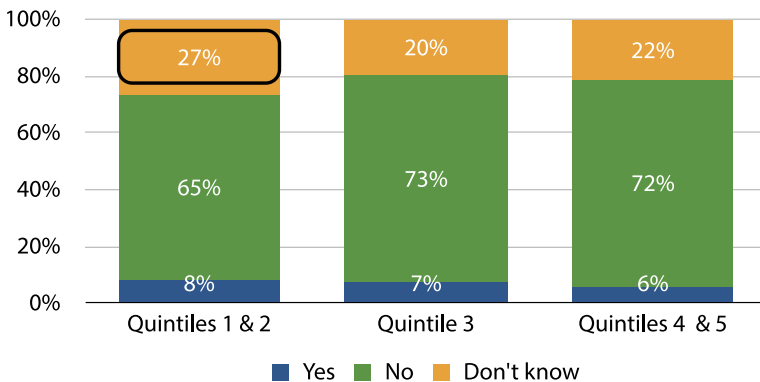
Again, there was little difference in the likelihood of applying to university for respondents from different POLAR4 quintiles.

Figure 12: Likelihood of applying to complete an undergraduate degree at a university - by quintile



And respondents from quintiles 1 and 2 were more likely to be unsure about whether the model would impact their choice of university.

Figure 13: Would this funding model affect university choice - by quintile



Scenario 4 – Modelling a graduate employer levy

Johnny Rich, Chief Executive of the Engineering Professors' Council and Chief Executive of the outreach organisation, Push

In 2018, HEPI kindly published my proposal for a graduate employer levy, a scheme for fairer funding of higher education through employer rather than graduate contributions.¹⁴ In his round-up of the year, Nick Hillman later described it as HEPI's most radical report, but what may have seemed radical then appears to be mainstream now.¹⁵

In October 2023, Public First conducted a huge survey (over 8,000 respondents) of public attitudes to tuition fees: 59 per cent supported a move to an (albeit undefined) levy on graduate employers. This compares to 43 per cent support for a graduate tax and 46 per cent for higher taxpayer contributions.¹⁶

What is the proposal?

The idea is to spread costs more fairly between all the beneficiaries of higher education and to ensure the funding follows the common interests of students / graduates, higher education institutions, taxpayers / society and employers. The version of the proposal that London Economics has modelled is a development of my 2018 paper and has four parts:

1. There would be no tuition fees for UK students. Instead, rather than deducting student loan repayments from graduates at source, employers would pay a levy of 3 per cent of graduate earnings over £25,000 directly to the government (or an agency like the Student Loans Company). Note that this is a third of the current repayment rate.
2. Students would be entitled to borrow a maintenance loan on the same terms as currently, which would also be repaid on similar terms to the current ones, but, like their employers, they would pay just 3 per cent of everything they earn over £25,000 rather than the current 9 per cent. As with the current English system, they would pay no real interest on the loan (interest would be pegged to inflation only), and the £25,000 threshold would track inflation too (following the initial freeze until 2027/28 inclusive).

3. The graduate employer levy payments would be passed to the higher education institution where the graduate studied.
4. To discourage higher education institutions from admitting students purely based on earning potential (which would be bad for access), there would be a National Access Fund, with benchmarks set for access and participation. Those institutions that miss their benchmarks would pay into the fund proportionately and those that exceed them would draw down from it. Annually, this would redistribute perhaps £1 billion around the sector.

Obviously, this leaves a funding gap for higher education institutions while they wait for the levies to start mounting. So the government would lend to the higher education institutions an amount equivalent to the current tuition fees for each student. This would be repaid by the higher education institutions over time on the same basis as current student loan repayments. Government loans would be phased out over the same period as levy receipts arrive.

What is in it for students?

Students and graduates would get their education for free, and their debts from a maintenance loan alone would be far lower than their current burden. They would also be repaid at a less punishing rate. It is true that employers might offer them marginally lower gross salaries so that it does not cost them more than the current system, but because that amount would have been deducted from their salary as a student loan repayment previously, their take-home pay will not be any lower (and may even be higher because collectively the graduate and employer are paying a total of 6 per cent rather than 9 per cent).

Their higher education institutions will want to ensure that, whatever they study, students emerge equipped with flexible, resilient employability skills. They may even be able to draw on careers support, from their higher education institution, for many years to come.

What is in it for higher education institutions?

Higher education institutions get a long-term funding settlement linked to their ability to provide a valuable education to their graduates. As the

Exchequer will be slowly removed from the equation, higher education institutions will be less bedevilled by the vagaries of political fashions. Some institutions may choose to chase the high levy returns of expensive STEM courses. Others may prefer cheaper-to-deliver arts courses with perhaps lower returns, but which can be delivered at scale. I imagine most will hedge their bets with a good mix.

In any case, they may restrict some courses where the labour market need is limited (forensic science, for example), but they will still have to balance that with – as they do now – offering the courses that appeal to students. They will work hard to embed employability in even the apparently least vocational of courses.

What is in it for taxpayers?

Society gets a higher education sector incentivised to deliver high-quality graduates not only fit for the immediate labour market, but able to adapt as it changes. It would result in huge savings for taxpayers and, over a generation, the cost of higher education would be an ever-diminishing drain on the public purse.

There may be gaps in provision where course costs are high, but earnings are low – nursing or social work, for example – but, in line with the principle of the beneficiary pays, government can decide to subsidise those courses. Or, fairer still, it can pay those socially vital roles better, so they are worthwhile for graduates, higher education institutions and the wider good.

What is in it for employers?

Employers, which have long complained about the job-readiness of graduates, will finally get skin in the game. Higher education institutions will work harder to meet their needs not only in terms of producing graduates with demonstrable employability, but the supply of graduates will finally be a balance of what student demand and what courses higher education institutions are willing to lay on based on labour market needs.

If employers do not think graduates are worth a 3 per cent premium, they can save money by employing non-graduates (perhaps investing more in training staff instead). Experience, however, suggests otherwise: they will

continue to employ graduates because they already pay them a 9 per cent premium so that they can pay student loan deductions, and this will be reduced to 6 per cent.

The salary bill for employers is unlikely to be affected significantly for many decades to come and, when it is, the change will be gradual as high-earning – in other words highly employable – graduates reach the later stages of their careers.

And finally

Not only is this scheme fairer and more stable in the long-term, but the savings for the Exchequer would also provide headroom to be more generous than I have suggested: providing better support to students, especially those from disadvantaged backgrounds, and raising the unit funding available to maintain the high standards of UK higher education.

The cost of Scenario 4 – by London Economics

The introduction of the graduate employer levy under Scenario 4 would result in very substantial Exchequer cost savings of approximately £8.03 billion per cohort compared to the current system. Overall, the system would generate a large net surplus (of £6.03 billion per cohort), as the expected future Exchequer revenues from the graduate employer levy would far exceed the costs of fee grant, maintenance loan and teaching grant provision. This is because the 3 per cent levy is applied to all graduate salaries over £25,000 and continues to be paid for the whole of a graduate's working life. The levy does not end when a certain level of payment is reached, or after a set number of years, as the current tuition fee loan (and maintenance loan) repayment system does.

Compared to the current system, the introduction of fee grants would cost an additional £11.30 billion per cohort, and maintenance loan write-offs would increase by £308 million (due to the lower loan repayment rate). Against these higher costs, the graduate employer levy would generate revenues of £19.22 billion per cohort, and the Exchequer would save £423 million from the removal of fee loans and the associated write-offs.

In terms of the RAB charge, the negative impact of the lower loan outlay from the removal of fee loans is outweighed by the positive effect of the lower repayment rate – so that, overall, the RAB charge increases by 3.9 percentage points (to 8.0 per cent).

Table 5

Resource flows (£ / £m / %)	Baseline	Scenario 4	Difference
Net Exchequer cost (adjusted for RAB)			
Cost of maintenance loans	(£326m)	(£635m)	(£308m)
Cost of tuition fee grants	-	(£11,302m)	(£11,302m)
Cost of tuition fee loans	(£423m)	-	£423m
Cost of teaching grants	(£1,257m)	(£1,257m)	-
Employer levy contributions	-	£19,221m	£19,221m
Total	(£2,006m)	£6,027m	£8,033m
RAB charge (%)	4.1%	8.0%	+3.9 pp
Net income (for UK higher education institutions)			
Gross fee income	£11,302m	£11,302m	-
Teaching grant income	£1,257m	£1,257m	-
Cost of bursary provision	(£108m)	-	£108m
Total	£12,451m	£12,559m	£108m
The cost to the student			
Average debt on graduation	£50,500	£22,000	(£28,500)
Average lifetime repayments (M / F)	£53,800 / £42,100	£23,100 / £17,300	(£30,700) / (£24,800)

Higher education institutions would benefit from the assumed removal of access bursaries (£108 million). Importantly, note that the analysis here assumes that there would be no funding gap for institutions in terms of fee income, but that the Exchequer would pay the upfront costs of fees to higher education institutions (through fee grants) and then accrue the post-graduation graduate employer levy contributions.

Johnny Rich's proposal instead suggests that graduate employer levy contributions would be passed on to the higher education institution

where the graduate studied, with higher education institutions 'borrowing' fees from the Exchequer in the meantime (until the Levy contributions start to be paid). Our analysis does not include the impact of any potential institutional borrowing scheme on higher education institutions or the Exchequer.

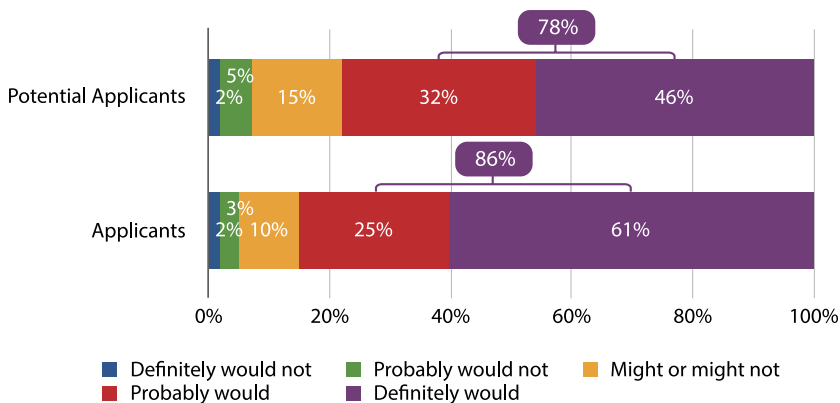
Potential applicant and applicant polling of Scenario 4 – summarised by Rose Stephenson

For Scenario 4, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *You will not be required to pay tuition fees.*
- *Maintenance loans are available.*
- *You will re-pay your maintenance loan as follows:*
 - *You will repay at a rate of 3% on everything you earn over £25,000 per year.*
 - *The debt will be wiped after 40 years.*
 - *You will be charged interest on your loan.*
- *The cost of your undergraduate degree education will be funded by companies that employ graduates. These companies will pay a levy (for example, of 3%) on top of graduate employees' wages, to the Government, who will pass this on to universities.*

In this scenario, we see an increase in the likelihood that potential applicants and applicants will apply to complete an undergraduate degree at university. Seventy-eight per cent of potential applicants and 86 per cent of applicants 'probably' or 'definitely would', compared with 68 per cent and 77 per cent in the baseline scenario.

Figure 14: Likelihood of applying to complete an undergraduate degree at a university



Ten per cent of potential applicants, and 10 per cent of current applicants state that this model would affect their choice of university. When asked 'in what way' their choice would be affected, respondents stated:

It would allow for me to go to any university of choice without taking too much cost considerations into account and instead being able to pick my education based on what is best for me.

I would apply to universities that I knew offered prestigious courses and degrees.

I would apply to the best universities for my course as money would not be an issue for me in this model and I would be able to pursue the best career possible.

To maximise the possibility of being employed by a company, I would aim for higher quality education and more respected universities.

I would feel able to apply to universities in areas that cost more to live in.

Since payment will not be an issue, I would apply for better universities in better area like Oxford or Cambridge.

I would not worry too much about maintenance loan and cost of rent as I wouldn't have less debt that I would have if I had to pay tuition fees. I would be aiming for more prestigious universities.

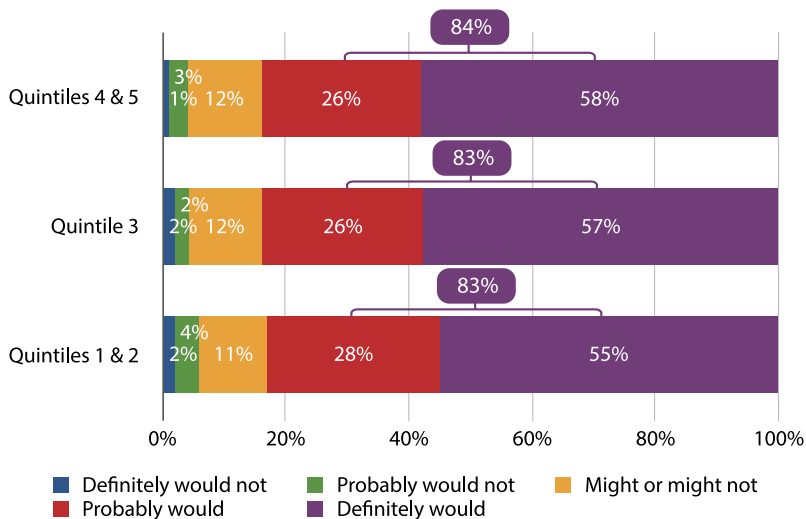
I'd apply for the best!

One respondent did raise some concerns about this model:

I feel as though the level of funding to different universities will be extremely unequal as it is more than apparent that students from certain universities are more desirable than others for employers. This could lead to further divides between education in the north and south and overall between poorer and richer areas. I also believe it is unreasonable to expect these companies to fund these undergraduate degrees.

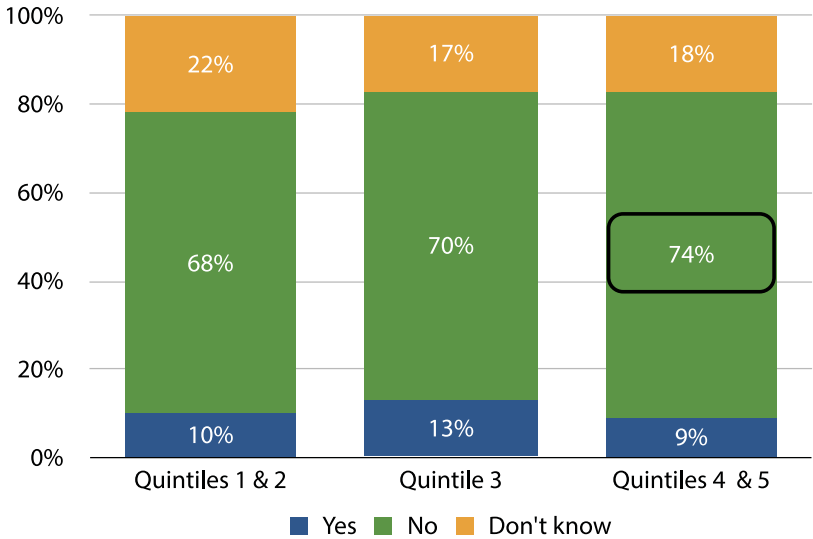
Again, there is little-to-no difference between respondents from different POLAR4 quintiles.

Figure 15: Likelihood of applying to complete an undergraduate degree at a university - by quintile



And respondents from quintiles 1 and 2 are more likely to be unsure of whether this model would affect their choice of university.

Figure 16: Would this funding model affect university choice - by quintile



Baseline scenario – The cost of the current undergraduate degree funding system in Scotland

London Economics

Key points:

- Scottish students do not pay tuition fees in Scotland. Instead, fee grants are paid by the public purse, at a cost of £247 million per cohort.
- Maintenance loans are available. Full-time undergraduate students living away from home are eligible for a loan between £6,000 to £8,000 per year, depending on household income.
- Maintenance grants of up to £2,000 are also available, depending on household income. Maintenance grants cost the public purse £76 million.
- Higher education institutions receive income in the form of teaching grants, costing the public purse £884 million per cohort.
- There is also a cost to the public purse for the write-off of unpaid maintenance loans. This costs £147 million per cohort, plus £12 million in tuition fee loan write-offs for Scottish-domiciled students who study elsewhere in the UK.
- There are student number caps in place in Scotland.

The cost to the public purse

Under the current baseline funding system for Scotland in 2023/24, the public purse contributes approximately £1.37 billion per cohort of Scottish-domiciled students (£1.36 billion from the Scottish public purse and £4 million from higher education funding bodies in the rest of the UK).^v

The relatively low fees for students studying in Scotland imply that most

^v This relates to teaching grants paid to English higher education institutions by the Office for Students, and to Welsh higher education institutions by the Higher Education Funding Council for Wales. Scottish domiciled students studying in Northern Ireland typically do not attract any teaching grant funding, since these students are charged much higher tuition fees as compared to 'home' students studying in Northern Ireland – so that the teaching grants paid to Northern Irish higher education institutions generally apply to 'home' domiciled students only.

of the Exchequer cost of the system relates to teaching grants, which cost £884 million per cohort (including £880 million for Scottish higher education institutions and further education colleges (allocated by the Scottish Funding Council) and £4 million for English and Welsh higher education institutions – allocated by the Office for Students and the Higher Education Funding Council for Wales, respectively). Fee grants and maintenance grants cost £247 million and £76 million, respectively. Maintenance loan write-offs cost the public purse £147 million per cohort, while fee loan write-offs (for students studying in the rest of the UK only) cost £12 million. The RAB charge is estimated at 20.6 per cent.

Table 6

Resource flows (£ / £m / %)	Baseline scenario
Net Exchequer cost (adjusted for RAB)	
Cost of maintenance grants	(£76m)
Cost of maintenance loans	(£147m)
Cost of tuition fee grants	(£247m)
Cost of tuition fee loans	(£12m)
Cost of teaching grants	(£884m)
Total	(£1,366m)
RAB charge (%)	20.6%
Net income (for UK higher education providers)	
Gross fee income	£326m
Teaching grant income	£884m
Cost of bursary provision	(£1m)
Total	£1,210m
Students / graduates (full-time first-degree students from Scotland studying in Scotland)	
Average debt on graduation	£32,600
Average lifetime repayments (M / F)	£33,200 / £22,000

The income for institutions

Higher education providers^{vi} receive approximately £1.21 billion in net income per cohort, including £326 million in fees and the above £884 million in teaching grants. Against this income, higher education institutions (outside of Scotland) contribute £1 million per cohort in bursaries.

The cost to students

The average debt on graduation per student (for full-time first-degree students from Scotland studying in Scotland) was estimated at £32,600, with average lifetime repayments of £33,200 and £22,000 for male and female graduates, respectively.

Potential applicant and applicant polling of the baseline scenario for Scotland– summarised by Rose Stephenson

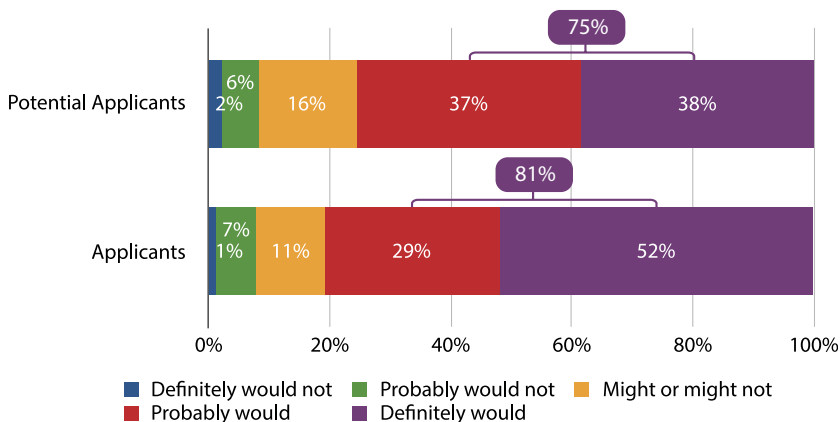
For the baseline funding scenario in Scotland, respondents – based in Scotland – were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *As a Scottish student, you do not need to pay tuition fees to study in Scotland.*
- *Maintenance loans are available.*
- *You will repay your maintenance loans as follows:*
 - *You will repay at a rate of 9% on everything you earn over £27,660 per year.*
- *The debt will be wiped out after 30 years.*
- *You will be charged interest on your loan.*

There is a strong likelihood that potential applicants and applicants will apply to study an undergraduate degree at university under the baseline (current) scenario in Scotland. As with the English baseline scenario, 100 per cent of the applicants have already applied to university – and therefore the same caveats apply to the polling.

^{vi} Again, note that, in addition to higher education institutions anywhere in the UK, this also includes Scottish further education colleges.

Figure 17: Likelihood of applying to complete an undergraduate degree at a university



Twenty per cent of potential applicants, and 24 per cent of applicants state that this model would impact which university they chose to apply to. When asked 'in what way' their choice would be affected, they responded:

If I [am] able to get funding for going to university in Scotland then I am a lot more likely to stick to Scotland when applying for University rather than branching out to other parts of the UK.

I would be applying to a Scottish university so that I get the free tuition.

I'd only apply to Scottish schools or schools in Scotland.

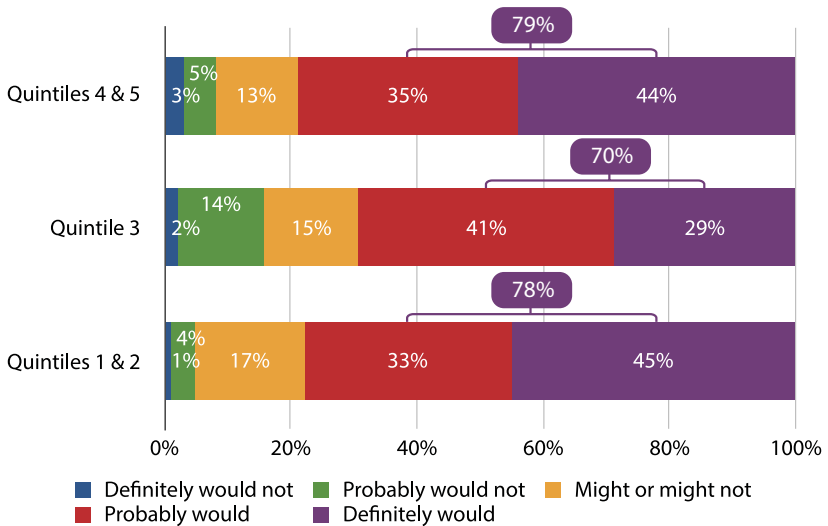
Even with free tuition, students are concerned about the cost-of-living, and this is impacting their choice of institution:

The cost of living including accommodation is very high in Edinburgh and shortage of supply so concerned regarding cost and availability. I have not chosen [a] course at Edinburgh for that reason.

I would try find the cheapest place to live in the look at surrounding universities.

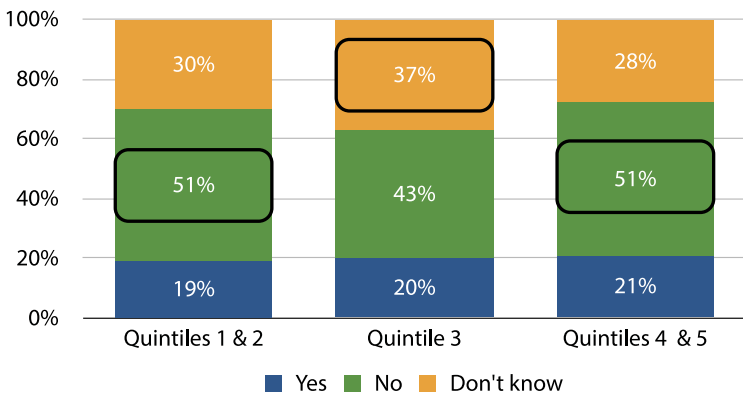
Fewer potential applicants / applicants from POLAR quintile 3 are likely to apply under this model.

Figure 18: Likelihood of applying to complete an undergraduate degree at a university - by quintile



And respondents from quintile 3 are more likely to be unsure whether this model would affect their university of choice.

Figure 19: Would this funding model affect university choice - by quintile



Scenario 5 – A graduate contribution model in Scotland

Alison Payne, Research Director at Reform Scotland

There may be no university tuition fees in Scotland, but there is a cap on student numbers. And while more Scots are going to university, places are unable to keep up with demand. Since 2006, there has been a 56 per cent increase in applicants, but an 84 per cent increase in the number refused entry. It is increasingly the case that students from the rest of the UK or overseas are accepted on to courses in Scotland, while their Scottish counterparts are denied. More people want to go to university, but the fiscal arrangement is holding ambition back. Reform Scotland believes that the current funding arrangements are unfair and unsustainable. There needs to be a better balance between the individual graduate and taxpayers, with graduates contributing towards the cost of their tuition through a graduate contribution, to be paid once they earn more than the Scottish average salary. The amount paid would be based on the amount you earn. If a graduate does not gain much financially from going to university, they will repay little or nothing. In addition, given the demographic challenges and skill shortages that Scotland faces, the Scottish government could then look to introduce schemes that cut or scrap payments for graduates who remain in Scotland working in certain sectors for set periods of time.

Background

Although tuition fees were introduced throughout the UK in 1998, the advent of devolution in 1999 and the passing of responsibility for higher education to Holyrood began the period of divergent funding policies.

The Labour / Lib Dem-commissioned Cubie report called for up-front tuition fees to be replaced with a Scottish graduate endowment scheme, whereby the Scottish Executive paid the fees and students would be required to pay £3,000 back when their earnings reached £25,000 a year.¹⁷

Tuition fees were scrapped, and a graduate endowment was introduced from 2001/02, with the first students becoming liable to pay the fee from April 2005. However, the scheme called for students to pay back £2,000 once they started earning over £10,000, a lower threshold than Cubie had

recommended. The graduate endowment was then scrapped by the SNP Scottish Government in February 2008.

A quirk of EU law meant that students from EU countries could not be discriminated against and could not be charged tuition fees if Scottish students were not paying them but students from England, Wales and Northern Ireland could be charged. As a result of Brexit, from 2021/22 EU students now have to pay tuition fees in Scotland.¹⁸

The policy of ‘free’ higher education is generally supported by all the political parties, although the Scottish Conservatives have changed their view on this issue in the past – the party’s latest Holyrood manifesto, from 2021, committed to maintaining taxpayer-funded tuition.¹⁹

Despite this unusual political consensus, the policy is becoming increasingly unsustainable.

Table 7

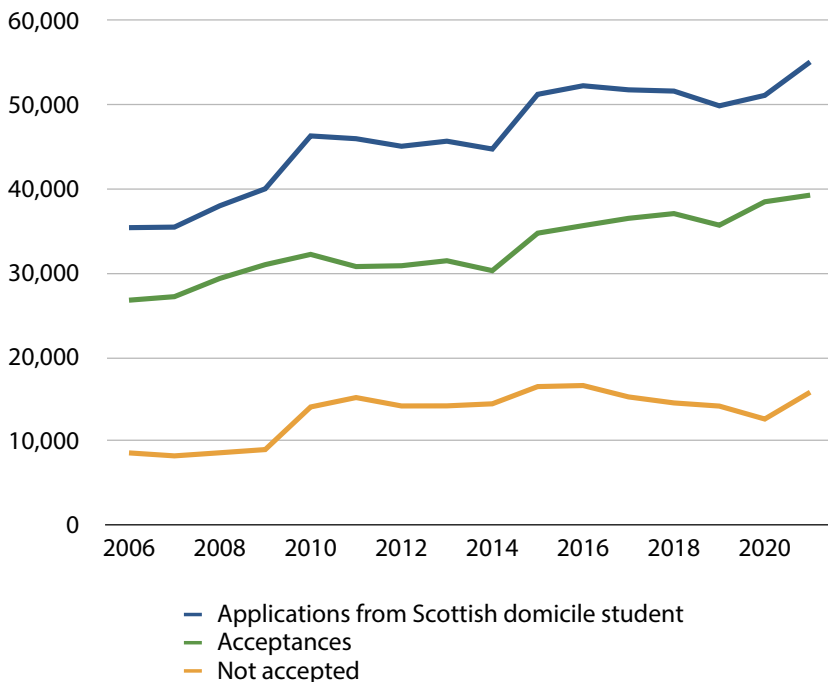
	Applicants	Acceptances	Rate	Not accepted
2006	35,430	26,800	75.6%	8,630
2007	35,495	27,220	76.7%	8,275
2008	38,035	29,390	77.3%	8,645
2009	40,055	31,030	77.5%	9,025
2010	46,345	32,250	69.6%	14,095
2011	46,015	30,800	66.9%	15,215
2012	45,115	30,900	68.5%	14,215
2013	45,720	31,495	68.9%	14,225
2014	44,785	30,315	67.7%	14,470
2015	51,295	34,775	67.8%	16,520
2016	52,315	35,670	68.2%	16,645
2017	51,830	36,540	70.5%	15,290
2018	51,680	37,105	71.8%	14,575
2019	49,925	35,725	71.6%	14,200
2020	51,170	38,510	75.3%	12,660
2021	55,150	39,300	71.3%	15,850
2006 to 2021	+55.7%	+46.6%	-5.8%	+83.7%

Source: UCAS

A cap on ambition

Data from UCAS, highlighted in Table 7, show that there was a 56 per cent increase in the number of Scottish-domiciled applicants to Scottish universities between 2006 and 2021 and a 47 per cent rise in the number of acceptances – a huge increase over only 15 years. However, there has been an almost doubling in the number of Scottish-domiciled students who have been unsuccessful, from 8,630 in 2006 to 15,850 in 2021.²⁰

Figure 20



With the Scottish government funding Scottish places, those places are limited, and as supply is not keeping up with demand, many Scots are finding it harder to get into Scottish universities.²¹ As a result, those finding that they cannot access a taxpayer-funded place in Scotland may choose to study elsewhere where there are fees or consider alternative career and educational choices.

The Scottish Affairs Select Committee's report on universities from 2021 highlighted this problem:

As students pay for their own tuition in other parts of the UK, a similar cap does not exist elsewhere (other than for a temporary period during the COVID-19 pandemic). It was reported in 2020 that, for the previous academic year, the unofficial 'cap' had led to only 55 per cent of university applications from Scottish students being offered a place at Scottish universities, compared to 74 per cent of English students at Scottish universities, raising questions about the impact the free tuition policy has on widening access for Scottish students.²²

There are widening access programmes in place to help ensure students from poorer backgrounds get into university courses. However, as Professor Dame Sally Mapstone, Principal of the University of St Andrews, has emphasised, it is the cap that is to blame for some students missing out, not the access schemes:

More young people from non-traditional university backgrounds are getting into university than ever before, but it also means that competition for places at our most selective universities is more intense and has more profound social consequences than ever before ... Contextual admission does not in itself disadvantage anyone. It is the co-existence of a capped numbers policy that does that.²³

Financial woes

The higher education sector in Scotland is not in great financial health. A 2019 report by Audit Scotland highlighted the growing fiscal pressures many Scottish universities were facing, with more than half of all such institutions in deficit. For most chartered and modern universities, the position had deteriorated since 2014/15. Audit Scotland pointed to financial pressures including pensions contributions, Brexit and estate maintenance. In the face of this decline, income from those students who pay higher fees was an important revenue stream.²⁴ Audit Scotland highlighted that 16 per cent of universities' income in 2017/18 came from non-EU tuition fees, compared to 7 per cent for Scottish tuition via the Scottish government and 4.6 per cent from 'rest of the UK' (rUK) fees.²⁵

It is worth comparing the huge variation in fees to highlight this point. For

example, to study Accounting and Business as an undergraduate at the University of Edinburgh, the cost for a full-time new student for 2023/24 is £1,820 per year for a Scottish-domiciled student (met by the Scottish government), £9,250 per year for someone from rUK and £24,500 for an international student.²⁶

The solution

There needs to be a better balance between the individual graduate and Scottish taxpayers in the contribution towards higher education. As a result, Reform Scotland believes graduates should contribute towards the cost of their higher education through a graduate contribution, to be paid once they earn more than the Scottish average salary. Reform Scotland would want to see a commission set up to examine what the fee should be, and whether it should vary to take account of differences in course costs.

In terms of what that cost should be, the Cubie report 25 years ago suggested a graduate fee of £3,000, which would be about £5,500 today.²⁷ This is the cost proposed by the Cubie report to cover an entire undergraduate degree in Scotland – it is not an annual (deferred) fee. This could perhaps be the starting point for the commission to examine. Any figure would need to take account of different variations in terms of the true cost of the course and potential skill shortages. We would not want to see a situation where government sets a maximum tariff, as is the case in England, Wales and Northern Ireland, which then becomes the norm.

The individual would only incur the fee upon graduation and begin paying it once they started earning the Scottish average salary.

While we believe that this is a fairer system, we also accept it means that there will be at least four years from when the system is introduced to the point that graduate fee revenue starts being collected.

Accepting that taxpayer funded tuition is unsustainable is the vital first step, particularly within the context of the broader fiscal issues facing the Scottish government.

However, introducing a graduate fee would not necessarily mean an end to 'free' tuition. Rather it provides an opportunity to look at the skills gaps that exist in Scotland and the possibility of developing schemes that cut off or

scrap repayments for graduates who work in specific geographic areas or sectors of Scotland for set periods of time.

Scotland is facing a demographic crisis. Our population is set to become older and smaller, and we are the only part of the UK projected to have a smaller population by 2045.²⁸ We desperately need to retain and attract more working-age people. Perhaps such graduate repayment waiver schemes could also be offered to students from the rest of the UK who choose to study in Scotland – stay here and work after graduation and we will pay a proportion of your fee. A wide range of different schemes could be considered and linked into the wider policy issues facing Scotland. According to the Higher Education Statistics Authority (HESA) there were 3,370 rUK graduates who were domiciled in rUK but attended a Scottish institution in 2020/21. Of those, only 990 chose to remain in Scotland for work after graduation. Could we encourage more people to stay after studying?

A graduate contribution should not deter people from going to university. The amount you pay back would be based on the amount you earn. If a graduate does not gain much financially from going to university, they will repay little or nothing at all. The financial expert Martin Lewis has referred to this as being in effect a no win, no fee education.²⁹

This policy could:

- end the cap on Scottish-domiciled students;
- reflect the benefits to both individuals and society of university education;
- help share the burden on public finances as we face long-term expenditure difficulties.

Scotland cannot afford to keep ignoring our higher education funding problems.

The cost of Scenario 5 – by London Economics

Compared to the current Scottish funding system, Scenario 5 would result in a small (2 per cent) increase in the Exchequer cost of the system, by £29

million per cohort - all related to the graduate contribution. Specifically, this cost captures the fact that some graduates are expected to not ever pay the full graduate contribution (for example, in instances where their earnings are below the earnings threshold above which this contribution would have to start being paid). Here, we assume that the Exchequer would incur the cost of these unpaid / outstanding graduate contributions (similar to the Exchequer cost associated with any maintenance and fee loans under the current system).

Table 8

Resource flows (£ / £m / %)	Baseline	Scenario 5	Difference
Net Exchequer cost (adjusted for RAB)			
Cost of maintenance grants	(£76m)	(£76m)	-
Cost of maintenance loans	(£147m)	(£147m)	-
Cost of tuition fee grants	(£247m)	(£247m)	-
Cost of tuition fee loans	(£12m)	(£12m)	-
Cost of graduate contributions	-	(£29m)	(£29m)
Cost of teaching grants	(£884m)	(£884m)	-
Total	(£1,366m)	(£1,395m)	(£29m)
RAB charge (%)	20.6%	20.6%	-
Net income (UK higher education institutions and Scottish colleges)			
Gross fee income	£326m	£326m	-
Graduate contributions	-	£154m	£154m
Teaching grant income	£884m	£884m	-
Cost of bursary provision	(£1m)	(£1m)	-
Total	£1,210m	£1,364m	£154m
Students / graduates (full-time first-degree students from Scotland studying in Scotland)			
Average debt on graduation	£32,600	£32,600	-
Average lifetime repayments (M / F)	£33,200 / £22,000	£33,200 / £22,000	-

Higher education institutions would benefit from an additional £154 million in net income per cohort, driven by the increase in fees (again, for first-degree students studying in Scotland only, while fees for all other students in the cohort would remain unchanged).

The average debt on graduation (per full-time first-degree student studying in Scotland) remains the same. This proposed system involves no changes to students' loan outcomes, but instead includes a – separate – graduate contribution for graduates who earn above the earnings threshold.

Potential applicant and applicant polling of Scenario 5 – summarised by Rose Stephenson

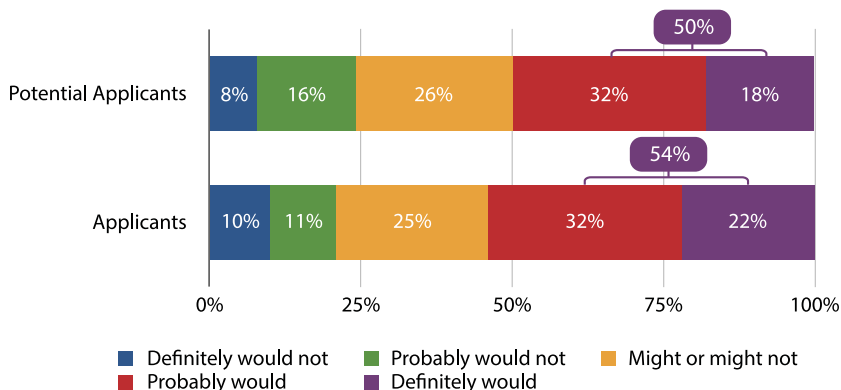
For Scenario 5, respondents were asked to state the likelihood that they would apply to complete an undergraduate degree at university if:

- *In this model, Scottish students will need to pay tuition fees to go to university in Scotland. You will not need to pay these fees upfront – you will pay them after you graduate.^{vii}*
- *As an example, tuition fees could be charged at £5,500 for a 4-year course (note, this is £5,500 for the whole course, not per year).*
- *Maintenance loans are available.*
- *You will re-pay your tuition fee loan and maintenance loan as follows:*
 - *You will repay at a rate of 9% on everything you earn over £27,660 per year.*
 - *The debt will be wiped out after 30 years.*
 - *You will be charged interest on your loan.*

Compared to the baseline (current) scenario for Scotland, we see a decrease in the likelihood that potential applicants and applicants will apply to university (50 per cent and 54 per cent respectively), compared to 75 per cent and 81 per cent in the baseline.

vii Again, a simplified version of the model was presented to respondents for the survey. The limitations of surveying potential students in relation to complex financial models is clear in the report. Further research would benefit from in-depth focus groups, with a large number of respondents. This was outside the scope of this report.

Figure 21: Likelihood of applying to complete an undergraduate degree at a university



A quarter (25 per cent) of potential applicants and 26 per cent of applicants state that the model may affect their choice of university – slightly higher than the rates of the baseline scenario (which were 20 per cent and 24 per cent).

When asked ‘in what way’ the model would affect their choice of university, respondents stated:

I would have to stay close to home to minimise the amount of money I would need to spend so I have enough to pay for tuition.

As I live in Scotland, this would affect me. I will have to consider which courses I can and can't afford, ultimately having less freedom in this decision.

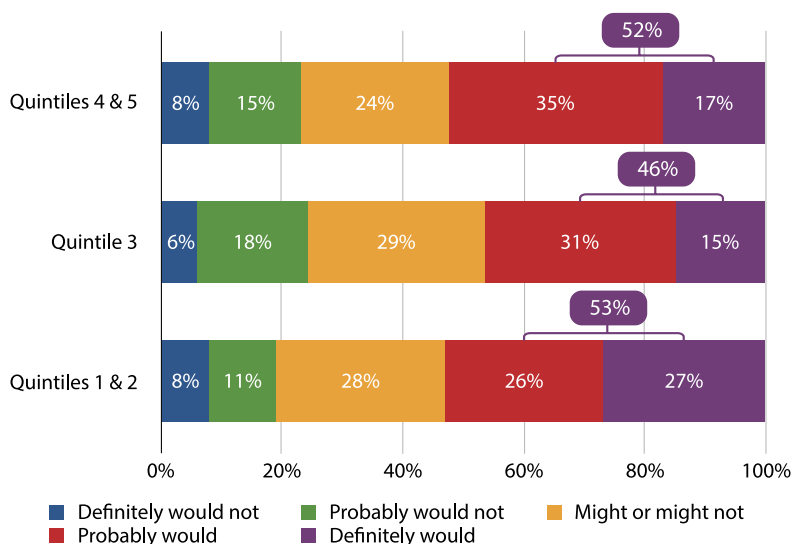
If Scottish universities cost me nearly as much as other universities in the UK, studying in Scotland would become one of many good options rather than being my best option.

Still cheaper than English schools so would apply mainly to schools within Scotland.

The first two responses show a poor understanding of the model, with the respondent presuming that they would 'need enough money to pay for tuition' or that they would need to choose a course they could afford. This highlights again the difficulties in being able to clearly explain funding models to potential students in a few lines of text.

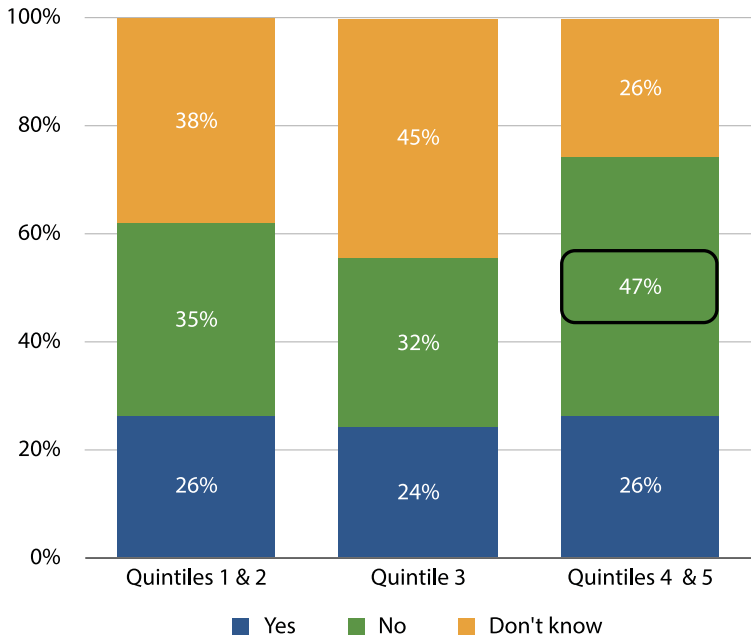
Again, we see POLAR quintile 3 respondents state they would be less likely to apply under Scenario 5, compared to respondents in other quintiles.

Figure 22: Likelihood of applying to complete an undergraduate degree at a university - by quintile



And respondents from quintile 3 are more unsure about whether this funding model would affect their choice of university.

Figure 23: Would this funding model affect university choice - by quintile



Financial sustainability of higher education institutions

Lily Bull, Policy Manager at the Russell Group

Introduction

The value of universities is often well recognised and goes beyond the core roles of education and research. They drive economic growth, develop cures to illnesses, help solve society's problems and serve a public good – offering free museums, support for local schools and more. And yet there is a disconnect between policymakers, the public and universities about the financial health of the sector and what is needed to keep delivering these benefits.

This chapter assesses the scale of the financial challenges faced by English universities under the current funding system, explores why universities cannot easily address these challenges without substantially changing their business model, and considers the consequences and difficult decisions they might be required to take if there is not a change in approach to how universities are funded.

The financial situation for English universities under the current funding system

In 2019, before COVID-19, sector data for England revealed that the income universities received for delivering their activities, including from the government, international and domestic student fees and commercial income, was £2.8 billion short of covering the cost of sustainably delivering these activities.^{viii} This includes performing research and development (R&D) activities, educating UK students and local civic engagement.

There are three primary factors driving these shortfalls, each increasing year-on-year:

1. Funders of R&D are covering a lower proportion of the costs of doing research

English universities have experienced a decrease in the proportion of costs covered by research funders. In 2016, Research Councils and

viii TRAC 2021/22: Transparent Approach to Costing (TRAC) serves as our primary data source for understanding a higher education institution's costs in England.

charities funded, on average, 72 per cent of the full economic costs of R&D projects they supported, with universities covering the remainder. By 2021, this fell to 69 per cent for Research Councils and 68 per cent for charities.^{ix} This is now notably below the policy intent for Research Councils to fund 80 per cent of the full economic costs of R&D. While it is recognised that universities should have some form of financial interest in research outcomes, decreasing levels of income for each R&D project from funders is making it increasingly hard to sustain the same level and quality of research activity.

2. *The value of funding that universities receive to educate UK undergraduates has fallen*

The current system was designed to ensure that the education of UK undergraduates would be fully funded through a combination of government grants and student fees. In aggregate, this held true until around 2015, but we now estimate that in 2022 English universities (on average across the whole sector) were required to supplement the cost of educating each UK undergraduate student by £2,500 per year.^x This deficit has been driven by a decrease in income per student with fees being frozen at £9,250 since 2017 (now worth around £6,000 in real terms) and government funding for education failing to keep up with inflation.³⁰

Despite this decrease in resource, rising expectations remain for what this income is expected to cover. This includes areas where demand has increased, such as mental health services and hybrid digital provision, and where there are new requirements such as cybersecurity measures for students and staff.

3. *Increased need to support local communities*

Universities are well placed to deliver regional benefit and have been doing so for many years. However, as the UK wrestles with low growth and productivity, universities are being called on to deliver increased

ix This includes grant funding from charities and the charity funded element of QR, CRSF (Charity Research Support Fund).

x Although even then, some institutions were having to cross-subsidise elements of their provision.

levels of support for their local areas. Given the limited external funding sources to support this, civic activities are being funded in the main through central university funds. The same pot is already being used to cross-subsidise R&D and educate domestic students.

This cross-subsidisation has been examined in detail in three previous HEPI reports: Vicky's Olive's report *How much is too much? Cross-subsidies from teaching to research in British Universities*, Nick Hillman's report *From T to R revisited – Cross subsidies from teaching to research after Augar and the 2.4% R&D target* and a report by Hillman, Dickinson, Rubbra and Klamann: *Where do student fees really go? Following the pound*.³¹

What would happen to the deficit if the funding system does not change?

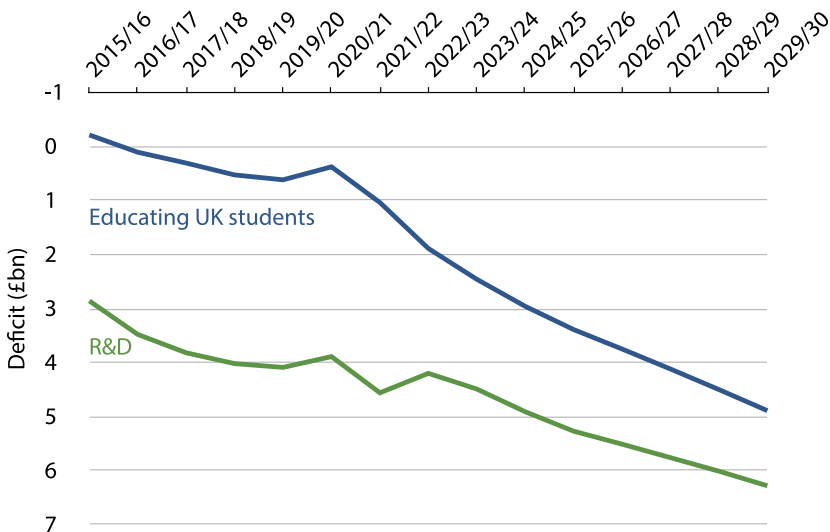
Russell Group modelling suggests that if the current funding system remains unchanged, by 2030 English universities will be required to find an additional £6.5 billion to maintain the status quo in student numbers and R&D activity as delivered in 2019.^{xi} This is in addition to the deficit the sector is already experiencing to deliver these activities. At a per-student level, the deficit for educating each UK undergraduate student would rise from £2,500 in 2022 to £5,000 in 2030 per student per year.

To avoid these big numbers would require significant policy interventions. For example, to prevent the additional £6.5 billion deficit by 2030, Russell Group modelling suggests government would need to increase undergraduate fees to £11,295 in 2024 and then in line with inflation each year, increase teaching grant funding by 6 per cent each year and ensure that government, charity and funding for postgraduate research students covers 80 per cent of the full cost of delivering those activities. This is not a policy recommendation but is included to illustrate the scale of the change that would be needed to avoid the additional looming deficits in addition to the deficit universities are already managing.

xi Student fees are held at £9,250, government grants for educating students (postgraduate taught and undergraduate) are held constant and income for research and development increases only in line with inflation.

Notwithstanding these issues, the challenge is likely to be compounded by the 131,000 extra 18-year old school and college leavers in the UK who are expected to look to enter university in 2030 and the Government's ambitions to increase R&D.³²

Figure 24: Historic / projected deficits of educating UK students (UG & PGT) & delivering R&D in English universities^{xii}



What are the consequences of maintaining the current funding system?

Without additional financial investment, universities are unlikely to be able to address the increasing deficits without significantly changing the nature of their offer.

As large, successful institutions that receive significant amounts of public

xii Research and education deficit 2015/16 to 2021/22: Transparent Approach to Costing (TRAC) for higher education providers in England and Northern Ireland; 2021/22 to 2029/30 projection of deficits using a baseline of 2019, Consumer Price Index and assumed pay inflators. This model uses 2019 data as a baseline to project future trends given the volatility of the years affected by COVID-19 (2020 to 2022). However, the graph shows reported data through the COVID-19 years.

funding, universities are often quite rightly challenged to find ways to increase efficiency and deliver their activities at a lower cost. Universities do review efficiencies on an ongoing basis. During the COVID-19 pandemic, for example, costs were successfully reduced through a range of initiatives, such as purchasing consortia, centralised decision-making and resource sharing with other universities. However, given the extent of the funding shortfalls, the ability of many universities to make the required additional savings through further efficiencies seems limited. Many universities are therefore likely to need to focus on ways to increase income streams that make a surplus or reduce activities that incur deficits.

To date, the most significant, reliable source of surpluses for universities is international student fee income. This cross-subsidisation is at the core of many university business models – not just in the UK, but in many of our competitor countries such as Australia, Canada and the US – and is where, in the short-term, they can be most agile. The challenge is the scale of income increase that would be needed to cover projected shortfalls by 2030, through a combination of higher fees and larger cohorts. International students bring benefits including enhancing the learning environment and making a significant social, cultural and economic contribution to the UK, as well as adding to the UK's soft power. International students create a net economic benefit to the UK of £37.4 billion pounds and over a quarter of the world's countries are headed by someone educated in the UK.³³

However, increasing reliance on a single income stream that could be put under threat by geopolitics, global competition or domestic political pressures comes with risks that need to be managed. While universities would make every effort to maintain the number of domestic students, a rapid growth in international numbers would stretch teaching and accommodation space, putting pressure on places and the wider student experience.

Other income streams that universities could look to expand may be available but most will not be large or predictable enough to cover ongoing day-to-day deficits. For instance, philanthropic income is often tied to new activity or buildings, while commercialisation activities require significant

upfront investment and long lead-in times.^{xiii} Other commercial activities, such as renting out lecture theatres, are unlikely to reach the scale needed to cover the predicted scale of future deficits.

If funding shortfalls cannot be covered through income growth alone, universities may look to reduce activity that is currently delivered at a loss, such as publicly-funded research or local civic activities.

Particularly for research-intensive institutions, the largest deficits are incurred in delivering R&D, but decreasing activity in this area would have a significant impact on UK society and the economy, weakening our R&D skills pipeline and the quality of our world-leading research. This loss of R&D could prove critical for future health breakthroughs, spin-out activities and high-value job creation in sectors such as digital-creative, advanced manufacturing, green industries and AI. This in turn would diminish the reputation of UK higher education and our ability to attract global talent.

Any reduction in civic activity would also come at a cost. Universities are often one of the largest employers in their areas and will work with their communities to address local needs, support economic development and contribute to culture, sport and local cohesion by hosting public events, performances and exhibitions. They also offer *pro bono* legal, management and other expertise to organisations and individuals in their wider communities. Losing these activities would have a noticeable impact on local communities and regional economies.

Each university will respond to increasing funding pressures in its own way depending on its strategic aims and financial structure. However, without additional funding, many will need to make difficult and unwelcome choices to reduce the shortfalls while doing their best to mitigate the impact on research activity and quality / choice for students. These decisions, and any necessary changes to the business models of

xiii The Independent Review of University Spin-Out companies notes that investment into university spinouts has increased from £1.11 billion in the academic year 2015/16 to £5.29 billion in 2021/22 (p.28). It also notes that in 2021/22, UK universities made only £244m from licensing intellectual property and only £86m from sales in company shares, which collectively equal 2.1 per cent of their research expenditure (p.18), November 2023 https://assets.publishing.service.gov.uk/media/6549fcb23ff5770013a88131/independent_review_of_university_spin-out_companies.pdf

institutions, will inevitably impact the size and shape of the sector and the benefits delivered. Whether or not there is the political will to enhance the current funding system remains to be seen; but it is vital that policymakers understand the negative consequences of maintaining the *status quo*.

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This HEPI report, edited by Rose Stephenson, delves into the challenges of financing higher education. This timely report collates a series of essays, offering both well-discussed and novel ideas on reshaping the undergraduate funding landscape in the UK.

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The report provides a springboard for further debate towards securing the financial future of higher education across the UK.



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