Explained: how is it possible to triple tuition fees and raise no extra cash?

Official estimates suggest repayment levels of new £9,000 fees are so low that they may raise no extra cash. We explain how the student loans system works, and how this can happen

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theguardian.com, Friday 21 March 2014 13.44 GMT

Protestors scuffle with police during a student rally in central London against sharp rises in university tuition fees, funding cuts and high youth unemployment. Photograph: Carl Court/AFP/Getty Images

It was the policy which caused the Liberal Democrats more political pain than any other: tripling tuition fees, after pledging to abolish them entirely.

Now, less than four years later, a parliamentary answer to shadow education secretary Liam Byrne indicates the political pain may have had no economic gain: despite students now shelling out £9,000 a year rather than £3,000, there's little or no extra cash.

Seems impossible? Not in the weird world of the UK's student loan system. Here's how it all works.

The Background

Tuition fees were introduced in the first term of Tony Blair's Labour government, with students who began their courses in Autumn 1998 paying £1,000 a year. This was later controversially tripled to £3,000 a year for students starting their courses in 2006 or later, and then tripled again to a cap of £9,000 by the coalition government for students starting university in 2012.

To sweeten the pill of fees – and make it possible for cash-strapped students to pay them – a student loan system was introduced.

Unlike US student loans, or any other personal debt, UK student loans are designed to be based on a student's income: your repayments depend on how much you earn. In theory, at least, this is meant to ensure that every student can afford their repayments.

The system when the coalition came in to power worked like this. After graduation, the student loan company would take 9% of a graduate's income as loan repayment, until the balance was paid off. The first £15,000 earned each year was exempted from repayments.

In short, this meant a student earning £15,000 repays nothing, while someone on £16,000 repays just £90 a year, while a graduate on £25,000 a year repays £900.

After a given period (or if a graduate dies), the remaining debt would be written off.

What changed

The most obvious change as fees tripled was that the total amount owed by a typical student increases dramatically. All students are entitled to borrow the £9,000 a year for fees, plus a minimum of £3,610 towards living costs.

For a student on a three year degree course, this means graduating with **£42,800** of debt. This is a sum many graduates would never earn enough to repay before the 30-year time limit on the debt expires. This was well known by the coalition, who factored into their calculations an estimate that around 30% of loans would never be paid back in full.

As a result, tripling student loans was never going to result in a tripling of cash – but the only reason it could potentially be nothing is a series of other changes made at the same time, which had a variety of strange effects for graduates.

The good news for graduates was that the amount they could earn before repaying their loan increased from £15,000 to £21,000 (which cuts repayments for any graduate earning £21,000 or more by £540 a year).

The bad news was that the interest rates on the loans was sharply increased. The old loans system presently charges 1% above the Bank of England base rate – meaning a current charge of **1.5%.**

The new system changed this interest rate to either RPI inflation (RPI is always higher than the UK's main measure of inflation, CPI, which is used to calculate increases to benefits and other payments), or RPI inflation plus 3%, depending how much the graduate earns.

This means under the new system graduates face interest rates of up to **6.3% –** four times the old system.

For many graduates, this means the interest on their loans is higher than their repayments, making the new system a graduate tax in anything but name.

How that works in practice

This messy Conservative-Lib Dem compromise has some strange effects, good for some graduates and terrible for others. To explain that, we've modeled the careers of five bright young graduates.

To keep things simple, we've imagined they all graduated with **£42,800** of debt, went straight into work, and kept the same job for thirty years. This is a major over-simplification, but doesn't change the fundamentals of how the system worked.

John finished his degree, but decided professional life wasn't for him and went to work in a factory for **£15,000** a year. **George** became a nurse, earning **£26,000** a year – the UK's median full-time salary. **James**, a journalist, earns **£41,000** a year. **Mona** became a high-powered analyst on **£54,550** a year while **Ami** became a banking fat-cat, pulling in **£100,000** a year for her thirty-year career.

Here's what they repaid over 30 years – and the balance they each "defaulted" on by the end.

If the situation looks strange, that's because it is. John, George and James all have balances of around £100,000 left on their accounts after 30 years, despite the fact

James repaid £54,000 and John repaid nothing.

Meanwhile, Mona and Ami both repaid their loans, but Mona paid back almost £40,000 more than her richer counterpart. This is because Ami paid off her loan in a mere seven years, while it took Mona the full thirty.

The end result can, therefore, be somewhat unfair: James and Mona each spend more than 4% of their career earnings on their loan, while Ami spends less than 2% – the same as our nurse on just £26,000 a year (an okay, but subpar, salary for a graduate).

So...where's the money?

When the government is calculating how much money the new student fees system will generate, it's hoping for lots of graduates like Mona and Ami, and as few as possible like John and George: people who will earn enough to repay the loan.

Initially, the estimate of how much loan money would never be recouped was about 30%. This week, the Department for Business, Innovation and Skills, admitted in a parliamentary answer that this estimate now stands at 45%.

This is a huge gap, given around £10bn a year of student debt is issued: the government now expects to recoup £1.5bn a year less than it expected.

Independent estimates think that at a default rate of around 48% to 49%, the extra cash from higher fees is outweighed by the higher costs and the foregone repayments from raising the threshold from £15,000 to £21,000.

So: graduates owe more money and have bigger loans, but the system gets no extra cash overall. The new system essentially creates a squeezed upper-middle: graduates earning around £40,000 to £70,000 get the worst deal.

What does it all mean?

The big question ignored so far is why the government's estimate of student loan defaults has risen so dramatically so quickly, especially as it's a projection based on 30 years of looking ahead.

Part of the explanation lies in people who aren't staying in touch to make their repayments. Anyone in full-time employment has their loan automatically taken from their pay packet, just like income tax and national insurance. But keeping in touch with students from the EU, or self-employed people, has proven trickier than the original optimistic forecasts predicted.

The increase in short-term employment, freelancing and self-employment among recent

graduates also makes more of them harder to track – and so harder to get cash from.

These issues alone would not explain such a seismic shift in repayments. The bigger factor is a grim one for graduates: the estimate change essentially reflects the forecasters getting ever-less optimistic about the earning potential of graduates.

In part, this can reflect data suggesting people who graduate into recession take a lifetime hit on earnings, and that lifetime earnings are heavily affected by your salary in the first few years of employment.

It could also be that analysts believe the relatively high rate of youth unemployment in the UK is now structural, and will be with us for a long time – or that as more people go to university, a smaller proportion of graduates will get "graduate" jobs.

More will end up in jobs traditionally associated with school leavers, or even unskilled work.

Something for something

The likelihood is the analysts have taken in a combination of all of those factors, and many more. It's possible that the current pessimistic forecasts may prove as unreliable as the earlier optimism.

Only time will tell that. But until then, the poor prospects of UK graduates are leaving around £1.5bn a year in money for the education system on the table: if the government could spend to improve employment or conditions for graduates, they would repay more money and boost education funding.

There is, in essence, money on the table: spend a little to help tackle youth unemployment, and the government could get a lot of it back.

For now, though, such measures were notable only by their absence in this week's beer, bingo, and pensions budget.

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