**Tuition Fees in Higher Education**

**Consultation Paper 134**

Spring Conference 2018

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**Background**

This consultation paper is presented as the first stage in the development of new Party policy in relation to tuition fees in higher education. It does not represent agreed Party policy. It is designed to stimulate debate and discussion within the Party and outside; based on the response generated and on the deliberations of the working group a full policy paper on tuition fees will be drawn up and presented to Conference for debate.

The paper has been drawn up by the Federal Policy Committee with the assistance of David Howarth.

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Comments should reach us as soon as possible and no later than Friday 31st March 2018.

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# Introduction

## Scope of this paper

The FPC, in conjunction with Vince Cable as leader, and assisted by Professor David Howarth of the University of Cambridge and former MP for Cambridge, has been reviewing options for moving from the current loans system of financing student tuition in higher education to a graduate tax system. This consultation paper is designed to help the conference take part in that process.

This is not a review of the whole of higher education spending, even less of the whole of post-18 education and training. As a result, this paper does not deal with the funding of research or with post-18 education and training outside higher education.

The paper deals only with the tuition element of student support. The very big issue of student maintenance, through loans or an improved grant system, is not at this stage under review (although it is clear that if a graduate tax of some form was introduced it would be desirable for it to incorporate, at a minimum, the existing maintenance loans as well).

Our current policy, as expressed in the 2017 manifesto, is also that we would ‘reinstate maintenance grants for the poorest students, ensuring that living costs are not a barrier to disadvantaged young people studying at university.’ In addition, we would reinstate student nurse bursaries. Regardless of the outcome of this consultation we expect to retain those commitments. They will not be re-examined as part of this consultation.

## Structure of the paper

* + 1. This paper starts with a summary of the current situation. It then moves to the party’s policy goals, agreement about which is crucial for how policy might change. It then reviews the options for future policy in the light of those goals. It reviews the Conservative and Labour positions and sets out why those positions are inadequate. It then lays out two ways of bringing in a graduate tax, setting out the pros and cons of the approaches, rejecting one very specific version of the tax but supporting others and suggesting a combination of approaches. It also offers several add-on options, many of which we could adopt regardless of the main path chosen.

Once the party has set a direction of change, more detailed work will be needed on the precise route, including financial details.[[1]](#footnote-1) That in turn will require decisions about priorities for public expenditure and taxation.

# The current situation

* + 1. Universities charge students tuition fees but most students do not pay those fees themselves. Instead, the government, in the guise of the Student Loan Company, pays those fees in full and up front, in exchange for which the student takes on a debt of the same amount.

Repayment does not take the form of debt repayments but is income contingent. There is no repayment for graduate with incomes under a £21,000 threshold. The fee system, therefore, resembles a tax on income of 9p in the pound above the threshold, though formally it is based on debt.

As maximum tuition fees rise to over £9,000 per year, the average prospective tuition debt that new undergraduate students face will rise to over £25,000, out of total average prospective debt of around £50,000.[[2]](#footnote-2) We recognise that even though former students are only required to pay this back in instalments once they are earning, having such a large amount of debt at the start of their working life can cause some students anxiety, as do the annual statements showing just how much is left to pay off. The combined effect is of ‘sticker shock’ throughout a graduate’s career. High interest rates of up to 6 percent add to the anxiety.

There is no evidence, so far, that anxieties about this have influenced the behaviour of young people. On the contrary, the number of applicants for universities has continued to rise and those from disadvantaged backgrounds have reached record levels, in marked contrast to the position in Scotland where the fee-loan system does not operate.

## Write-Offs

* + 1. Under the current system, after 30 years remaining debt will be written off. Currently, the government expects that three quarters of students will fail to repay at least part of their loan.[[3]](#footnote-3) This means that the Government is effectively continuing to subsidise tuition to an extent, although not in a way which is transparent to students or the wider public.

Indeed, one of the features of the system is that it seeks to achieve more generous funding of universities (and students) by opaque means. Government accounting rules help to explain this.

Government accounting practices represent this subsidy in a variety of ways, none of which gives a true view of the cost.

## Government spending on tuition

* + 1. A key objective of the Coalition government (and the Labour government before it) was to protect universities from the full impact of curbs on public spending which would have led to a reduction in student numbers and the quality of university teaching and research. Some would argue that the fiscal policy should have been different but, within the context of ‘austerity’, universities have been spared the cuts experienced in other areas of public spending.

We know from figures published by the Student Loan Company that around £8 billion a year moves from the government to the universities in the guise of tuition fees.[[4]](#footnote-4) We also know that the government regularly assumes that around a quarter of the sums it loans will not be repaid.[[5]](#footnote-5) That means that the true position is that the government is spending around £2 billion per year in subsidy for tuition.

In addition, the Higher Education Funding Council for England (HEFCE) spends around £500m a year on access schemes, London weighting and STEM premiums.

By way of comparison, spending on apprenticeships, through the apprenticeship levy, is around £2.7 billion a year but this is paid by employers, through a hypothecated tax, not directly by government. Spending on the Adult Education Budget will be held constant in cash terms at £1.5 billion up to 2019-20.[[6]](#footnote-6)

## Tuition Fees

* + 1. Hiding a subsidy in anticipated but uncertain write-offs of debt is not just bad in terms of transparency. It is also bad because it confuses critics and policy analysts about the relationship between fees, students and university funding. Seeking to do good by stealth, as governments have tried to do via the fee-loan system, has led not just to a confused debate but to dissatisfaction with the system.

We need a more honest debate on who should pay for universities and for students’ tuition. University education is a private good – graduates in general have higher lifetime incomes than those who choose other routes – and also a public good in raising the productivity of the economy and critical thinking. To the extent that university education is a private good the issue is how much and when graduates should contribute to meeting the cost. To the extent it is a public good the issue is who should pay the subsidy – government or employers – and how.

A more obvious way to reduce the financial burden of fees on students is for someone else to pay them, in part or in whole, as always used to happen. Furthermore, no need exists to match any amount raised from students or former students with the amount paid out in the form of fees. The amount raised could be less than, equal to, or more than the amount paid out, either for each student or for students collectively.

From the point of view of the universities, their income from domestic undergraduate students supported by the state is the full £8.5 billion, not £2.5 billion, since that is what they receive from state sources. How much of that £8.5 billion the state recovers from students is a matter for the state, not the universities. The reforms of 2012, after an initial negative stage, preserved university funding for first degrees and protected higher education from the full force of public spending restraint. The system of funding universities predominantly by tuition fees rather than by direct grant has the added advantage, at least in principle (if not always in practice), of maintaining the autonomy of universities, without which they could not carry out their functions. The sense that universities have abused that freedom by inflating Vice Chancellors’ salaries, or have failed to adapt their teaching model to the changing needs of students, is one of the sources of current dissatisfaction with the fee-loan system.

## Public benefits of higher education

* + 1. The best documented public benefits are a politically more sceptical, liberal and active population (which Liberal Democrats should value highly) and higher longer term economic growth through higher productivity.[[7]](#footnote-7) Other possible public benefits include a healthier population and fewer long term social problems.[[8]](#footnote-8)

Those benefits are arguably linked to the ways higher education works. Higher education is not merely a process of topping up information transferred to students in primary and secondary school. It is a training in how to assess and absorb new information one has acquired oneself and a glimpse of the creation of new knowledge. That can only be done if a significant proportion of teaching is carried out by academics active in research.

Higher education also offers a route to social mobility, although whether many travel that route depends on how it is organised. There has undoubtedly been a major expansion of access to higher education though some argue that it is at the expense both of quality and of vocational options, and may be creating diminishing or negative private and public returns.

Current policy impliedly values the public benefits of higher education at £2.5 billion a year. But whether that figure represents the party’s valuation of higher education is a question for the party to decide. It is arguable that the principal public benefits of higher education – a more open-minded, engaged and productive population – are far more valuable for a Liberal party.

## Autonomy of the universities

* + 1. The current system provides the universities with some degree of autonomy. Universities design and assess their own courses, largely free of central government direction (except through state-sponsored professional bodies) but are subject to a quality assurance system in addition to voluntary self-regulation through a network of external examiners. That autonomy is especially crucial for the credibility of research, but given the link between research and teaching in higher education, is arguably also crucial for the credibility of their teaching. The current system does not, however, grant the universities much financial or commercial autonomy, imposing a cap on what they can charge domestic (and EU) undergraduates.

The current system does, however, allow for some competition between universities in terms of quality, although as a market it does suffer from considerable informational and other defects.

## Fairness of repayment system

* + 1. Repayment of tuition fee loans under the current system is contingent on the former student’s income. Borrowers pay back 9% of their income above the threshold (currently £21,000) until their loan is paid off. In addition, the debt of those who earn more than the threshold increases by a real interest rate of up to 3% a year. The system is thus, in some senses, progressive. Former students whose incomes stay low for 30 years will pay little or nothing. Those on moderate incomes, some of whose debt is written off, pay less than those who repay their debt in full.

On the other hand, those who earn enough to pay their debt off early, by avoiding interest payments, pay less than those who, for example, finish paying off their over precisely 30 years. The system, through creating debt and involving interest payments, might also cause particular problems for debt averse segments of society, though there is little evidence of behavioural change in response.

Another issue is that the current system creates a potential charge on only some of those who derive a private benefit from the system. It does not, for example, charge employers, even though they too may benefit from employees who have been through higher education.

## EU students

* + 1. The current system treats EU students on the same basis as UK students. Because the loan is a private law contract, it can be enforced in other EU jurisdictions through the arrangements on the mutual recognition of judgments. Taxes cannot be enforced in other jurisdictions, even EU ones.

About 4% of the total outlay of the Student Loan Company is paid in respect of non-UK EU students.

# Policy Goals

The FPC has identified the following policy goals:

* + 1. **Eliminating sticker shock:** The one major feature of the current system which is problematic is the psychological impact of high levels of debt, even if the debt does not have to be repaired. If a means can be found to remove that negative signal, we should pursue it.

**Maintaining funding, quality and autonomy of the universities:** Any solution should not threaten the funding of the universities. It should also put some pressure on the universities to maintain quality without undermining their autonomy.

**Cost of the policy and the public value of higher education:** Any solution should not be more costly than the party’s valuation of the total public benefit of higher education or more costly to individual graduates than the current fees system.

**Fairness of payments into the system:** Any solution should be at least as fair as the present system and preferably more clearly progressive and inclusive and more comprehensive in scope.

**Fairness across and within generations:** Contributions should not put an inordinate burden on any particular generation and public support should be comparable over different post-school options (e.g. between higher education and further education, including apprenticeships). Our principle is to support lifelong learning through a variety of routes.

**Consistency with Liberal values:** Any solution should be consistent with the values of a Liberal party. That means that it should not include any policy that would create or depend on the exercise of arbitrary power. There is also a long Liberal tradition of not treating education as a commodity (as one of ‘those things which are chiefly useful as tending to raise the character of human beings’, to quote JS Mill) and so it would be preferable to remove any sense of buying education for oneself and to replace with, for example, a system of contributing to the cost of educating the next generation. The policy should also use transparent methods and seek to enhance accountability by democratic elections but without subjecting the universities to political control. Any solution should also be compatible with UK membership of the EU.

**Political attractiveness:** Any solution should offer a better deal not only to future students but also to those already in the system. It should also be a distinctive policy easily associated in the public mind with the Liberal Democrats.

**Practicality:** Any solution should not depend on implausible funding mechanisms or assume informational or administrative capabilities that the UK government does not have.

1. Do you agree with these policy goals?
2. Are there any you would drop or any further ones you would add?
3. What relative weight would you give to the different goals?

# Policy Options

4.0.1 No party is committed to the status quo and we assume that it needs reform. We do not believe the policies of the Conservative and Labour parties can meet the objectives we have set out for our higher education system. However, we think that it is worth considering options for a more explicit form of graduate tax.

4.0.2 A graduate tax can be done different ways: it can be done keeping the current private contractual basis for payments into the system or it can be done through a full tax – in essence a supplementary income tax. Furthermore, a supplementary income tax can be levied on different segments of the population, for example all those who graduate in the future or all those who have ever graduated.

4.0.3 We also set out some additional options that can supplement whichever main option is chosen. Although usually referred to as a single option, various options exist under the label ‘graduate tax’.

## Conservatives

* + 1. The Conservatives seem to want to keep the system roughly as it is now but to find cheaper options for students, albeit with higher fees for some Russell Group universities. A version of this option apparently under active consideration is to separate higher education into two sub-systems: one continuing to teach as now using expensive research talent, the other employing cheaper non-research active staff. The proposal for two-year degrees is only plausible if the system were to be divided in this way, since otherwise research-active staff would not have the time to carry out research.

Dividing the system into full-service and no-frills sectors would be difficult to achieve without extensive regulation of the form and content of courses and the internal organisation of universities, tasks for which central government is singularly unqualified and ill-equipped. Cutting off teaching from research would also reduce diversity of higher education.

## Labour

* + 1. Labour’s policy is to ‘abolish fees’, and it is the apparent attractions of this populist policy which is stimulating the policy debate. Since the universities derive £8 billion a year from fees, it implies replacing all the universities’ income from fees paid out by government through the Student Loan Company with direct funding of some sort, financed by increases in general taxation or increased borrowing.

Labour’s option would have more success than the Conservatives’ proposals in removing sticker shock, albeit at a net cost of £6 billion a year.

It would, however, only work for new students. As Labour has discovered, applying it to existing graduate debt would be prohibitively expensive. According to the Student Loan Company, total outstanding student debt for England stands at nearly £80 billion. Even if only tuition debt is written off (tuition debt makes up about 60% of recent loans made by the SLC) the sums are still formidable. That is presumably why Labour has abandoned its attempt to hint to graduates that it would lift them all out of debt.

As for the quality of education and the autonomy of the universities, a pure block grant system, which is what Labour seems to have in mind, would remove all competitive pressure on the universities to attract and retain students and, by confining funding for undergraduate teaching to a single source entirely dependent on state policy decisions, it would seriously threaten autonomy. Scottish universities already demonstrate the disadvantages of this system: political interference and erosion of standards, and reduced access.

Labour’s policy would also fail to pay for higher education in a progressive way. Because students come disproportionately from households on above average incomes and themselves come to earn above average incomes, paying for tuition from general taxation is less progressive than paying for it through the present system of income-contingent loans.

Labour’s approach would remove the commodity exchange basis of higher education but would not replace it with any sense of past beneficiaries contributing to the education of the next generation.

## Graduate tax systems

* + 1. Although usually referred to as a single option, various options exist under the label ‘graduate tax’.

#### Replace loans with individual income-sharing contracts

* + 1. The first form of graduate tax is not technically a tax but a private law contract under which individuals agree to pay the government a specified percentage of their income for a specified number of years.

Unlike a loan, an income-sharing contract creates no capital sum to be repaid and thus no debt. The individual might end up paying less or more than the sum paid on their behalf, depending on their future income.

In effect the student confers on the government a royalty on the student’s future income at rates and in bands agreed in the contract.

The government would continue to pay fees to the universities up front and in full on behalf of students who had signed up for the income-sharing contract, but the amount of the fee paid and the amount the student will pay into the system in the future would no longer be connected.

One important feature of income-sharing contracts is that, since they create no debt, they cannot be paid off early. The liability to pay lasts the full length of the contract (for example, 30 years, if that is the chosen liability period).

Another important feature of the income-sharing contract is that it would be possible to offer an opportunity to those paying loans to swap their loan contract for an income-sharing contract.

#### Charge a supplementary income tax

The second form of graduate tax is a supplementary income tax charged on a segment of the population. Several variations on such a tax exist:

* It could apply to people who have graduated from a university, or people who have attended a university, or it might vary according to the number of years attended (or full-time equivalent years attended).
* Universities covered might be any university in the world, or any in the EU or any in the UK or any in England.
* The period for which people are liable to pay the tax could be a specific number of years (e.g. 30, equivalent to the current liability for loans) or until a certain age or event (e.g. retirement, or for life.
* The starting date for liability can also vary – immediately after graduation, or a specific number of years after graduation.
* The tax could be a flat rate or it could be banded progressively.
* The tax could start at any level of income – for example the current starting income for the current loans or national average income.
* The tax could apply prospectively – that is to say only to those who attend or graduate from university after the tax comes in – or retrospectively to those who attended or graduated in the past.
* If the tax did not apply retrospectively, it would be possible to allow current loan re-payers to opt into the tax in exchange for the debt being remitted.

As with private income-sharing contracts, the government would continue to pay fees up front and in full to the universities, but the total amount paid into the system by those liable to pay the tax would not be connected to the total amount of the fees paid on their behalf.

## Assessment

Applicable to both forms

* + 1. Both forms of graduate tax, the private law version and the public law version, would mean that graduates would no longer face any debt for tuition. Although they would be liable for payments into the system that other people would not face, they would receive no annual statement of a capital sum they ‘owe’ and no interest rate. Contributions would depend solely on current income and the total contributed would not matter, whether that fell short or exceeded the sums paid on behalf of the student in fees.

Because the fee system would stay in place for the purpose of transferring money from the government to the universities, the current position on autonomy and quality would stay in place.

In terms of resources, because graduate tax payers cannot pay off their debt early (because there is no debt in the first place) one can expect an uplift in the resources generated by the system. That uplift (probably about 10%)[[9]](#footnote-9) could be devoted to reducing average contributions without any loss of resources available to the universities.

Contribution rates could be set in as progressive a way the government wants, consistent with raising the required funds. For example, a higher rate could be set for incomes over £100,000 with a compensating lower basic rate.

Crucially, both versions of the graduate tax can be extended to existing borrowers by offering them the possibility of opting into the new system, annulling their existing debt.

Differences between versions

The contract and tax versions differ in their advantages and disadvantages to some extent.

The contract version will, like loans, continue to be enforceable in private law and so could be offered without complication to EU students. Taxes are not enforceable outside the jurisdiction, but one might be able to make up for losses in a non-discriminatory way by imposing the tax on graduates of all universities, not just UK universities. That might be necessary anyway to avoid giving an advantage to graduates of cheaper higher education systems abroad. Collecting the tax in that event would have to be done by including an appropriate question on tax returns and carrying out the usual checks, which would involve some losses and costs.

One possible way forward would be to use the tax version for domestic students and the contract version for EU students, which would not be discriminatory as long as the effects are the same.

The tax version is easier to present than the contract version as not treating education as a commodity and as a contribution to the costs of educating later generations. But one might be able to achieve a similar effect by setting up a trust fund into which all contractual contributions would go, and out of which the fees of future students would be paid.

Cutting contribution rates

A crucial question is how attractive the system can be made by reducing contribution rates without loss of yield. The average contribution rate can be reduced by three percentage points for every £2 billion of subsidy. Several ways exist of doing this:

* Increasing the level of subsidy beyond the current £2 billion, funded by, for example:
  + Devoting the proceeds (or part of the proceeds) of increasing income tax on very high incomes (which would also add to the cross-generational fairness of the system)
  + Using the net proceeds of a new levy on employers parallel to the apprenticeship levy (remissible if the employer contributes to the cost of e.g. sandwich courses), which would add to the comprehensiveness of the system in terms of asking for contributions from those who derive private benefit from higher education
* Extending the liability period beyond the current 30 years
* Shifting the liability period so that it covers the whole period of maximum earning capacity (currently late 40s to late 50s for graduates) – which would have the added advantage of freeing new graduates from liability at the start of their careers at which point they are often earning less than non-graduates.

We should, however, note the current rough equivalence between the subsidy for higher education tuition and for further education including apprenticeships, and that a major increase in the subsidy for the former would raise the question of whether support for the latter should also be increased. Moreover, the cost of apprenticeship training has been shifted from the taxpayer to the employer and public support of Further Education is being cut. It would be highly undesirable to widen the already invidious treatment of vocational further education relative to universities.

Prospective v retrospective

A way of increasing the yield of the tax version of the new system (but not the contract version) would be to apply the tax retrospectively to all graduates whenever they graduated, including those who graduated before the loan system came in. That would be an alternative way of adding to the intergenerational fairness of the system (albeit less progressive than using the proceeds of a higher band of income tax).

The main problem with this option is that it violates the constraint that policy should not create or use arbitrary power. Retrospective taxation is bad in principle and has adverse long-term economic consequences. It is bad in principle because it taxes choices individuals have already made and cannot reverse. It has adverse long-term consequences because it increases uncertainty about the consequences of all future decisions. Governments that tax the past repel investment of all kinds.

This option also faces the same administrative difficulties as taxing the graduates of foreign universities. HMRC has no knowledge of who is a graduate outside those registered under the current system. It would have to rely on self-report and auditing those self-reports, both of which lead to losses.

1. Do you agree that both the contract and tax versions of a graduate tax offer a good way forward for policy?
2. Which of the options for increasing the yield of a graduate tax would you support?
3. Do you agree that a retrospective tax should be rejected?

# Additional ideas

* + 1. Switching from a loan basis to an income-sharing basis for graduate contributions, whether through contract or tax, provides an opportunity clearly to separate the system for funding universities from what individual students pay into the system. That means, other reforms become possible, including:
* Fees could include a premium along the same lines as the pupil premium, rewarding universities for taking on students from difficult backgrounds, improving access and equality.
* There could also be a premium to encourage teaching specific subjects (although we should be sceptical of the idea that STEM subjects inevitably generate greater public benefit than other subjects. For liberals the public benefit of higher education includes a sceptical and politically engaged population, which can be achieved by non-STEM as well as by STEM subjects).
* The funding pool for tuition, that is all the funds coming in from graduates, the state and employers, could be ring-fenced and placed under the control of trustees whose responsibilities would include ensuring value-for-money and arguing for adequate funding. Future governments could change the balance between sources, even eliminating the graduate tax if it wanted, without changing the structure.
* More radically and distinctively liberal, some trustees of the fund could be elected by all contributing graduates, creating a long-term incentive for universities to consider their graduates’ welfare over their working lives and shifting the emphasis of the system from selling higher education to 17-year olds, who are not in the best position to judge its value, to making it responsive to the views of graduates when they are able to judge.
* Contribution rates could also be varied with the years and type of higher education received, so that, for example, it could incorporate funding of graduate degrees in exchange for higher contribution rates.
* A fundamental change would be to tear down the barriers between further and higher education, academic and vocational, through the universal acceptance of BTec qualifications, the integration of university and apprenticeship application in UCAS; and the treatment of all students in the same way through access to student maintenance grants and teaching subsidies.

1. Which of these additional ideas do you support?
2. Do you have any further proposals along the same lines?

1. That would also be the time to carry out an audit of the policy’s probable impact on equality and diversity. At this stage, too many possible ways forward exist for such an audit to be a useful exercise. The FPC will, of course, nevertheless to consider these issues in coming to a decision on the general direction to set. [↑](#footnote-ref-1)
2. C. Belfield, J. Britton, L. Dearden and L. van der Erve, Higher Education Funding in England: Past, Present and Options for the Future (IFS Briefing Note BN211) (London, 2017) [↑](#footnote-ref-2)
3. Ibid at 19-20 [↑](#footnote-ref-3)
4. See Student Loan Company Table 4B(i) (at <https://www.slc.co.uk/media/8445/slcsfr052016.xlsx>). The number of students supported in this way is around a million. (The total number of students is higher than a million. It includes graduate students, foreign (non-EU) students and those who pay their own fees.) [↑](#footnote-ref-4)
5. See e.g. Belfield, Britton, Dearden and van der Erve above n. 1, who estimate that 60% of the 43% RAB they were looking at was attributable to non-repayment and BEIS’s latest estimates of the RAB, which assume much lower interest rates that those the IFS was analysing. [↑](#footnote-ref-5)
6. <http://researchbriefings.files.parliament.uk/documents/CBP-7708/CBP-7708.pdf> [↑](#footnote-ref-6)
7. J. Bynner, P. Dolton, L. Feinstein, G. Makepeace, L. Malmberg and L. Woods, *Revisiting the benefits of higher education* (London, 2002), G. Birkin, J. Evans and R. Moreton, *What do Good Outcomes from HE look like?* (Leicester, 2016) [↑](#footnote-ref-7)
8. Ibid. See also BIS, *The Benefits of Higher Education Participation for Individuals and Society: key findings and reports “The Quadrants”* (BIS Research Paper No. 146) (London, 2013). The claim that education to degree level brings better health is perhaps undermined by the more general finding that holding a higher position in any hierarchy is associated with better health. See M. Marmot, ‘Status Syndrome: A challenge to medicine’ (2006) 295 (11) Journal of the American Medical Association 1304. [↑](#footnote-ref-8)
9. See C. Crawford and W. Jin, Payback Time? Student debt and loan repayments: what will the 2012 reforms mean for students? IFS Report R93 (London, 2014) figure 4.11. Recent changes in interest rates, however, because they mean fewer graduates will pay off their loan in full, will reduce the advantage in yield of graduate taxes over loans. [↑](#footnote-ref-9)