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DEPARTMENT OF EDUCATION AND SCIENCE

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FROM THE SECRETARY OF STATE

Prime Minister:

Sir Keith's proposals on the review of student support

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1

I don't think this form of review will do. The first paper depends wholly on drafting by officials. No outside - no outsiders? who? MT

21 December 1984

FER 21/12

Dear Nigel.

REVIEW OF STUDENT SUPPORT

I have been giving thought to the conduct of the review of student support which I promised in my statement in the House on 5 December. I said then that we proposed to consider - and consult widely about - whether a radical change in the student support system, which might include loans, should be made so as better to meet the needs of students and their families whilst safeguarding the interests of the taxpayer. I hope that we can arrive at proposals which, sooner or later, save the taxpayer money.

My intention is that we should limit the review broadly to the area why? of mandatory awards, excluding support for postgraduate students and students in NAFE. Specifically, I propose that the terms of reference of the review should be

> "To examine financial support for students in higher education other than at postgraduate level".

This would allow within the scope of the review consideration of support for students on HE courses for which at present only discretionary awards are available, and also of support for those studying in HE part-time. There is legitimate interest in both these categories, especially the former. There would of course be no presumption that money could be made available for extension of support in these directions.

I envisage that the review process will comprise a Consultative Paper, which we should manage to issue in the period between March and May 1985; a period of about three months for comment; and a Green Paper or White Paper would follow still later. The White Paper might contain a promise to legislate, but how this will turn out is inevitably impossible to predict at this stage. The Consultative Paper would be issued in association with the Green Paper on Higher Education, which is now being redrafted to take account of this change.

I have in mind that the Consultative Paper, after setting the scene,

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should display a range of costed options. As you know, my own preference all along has been for the inclusion of a loan element in student support, and I would reckon to give prominence to options with this character. There are, however, as we have recognised before, and as commentators are already remarking, difficulties about loans. In particular, if every student is to have a right to a loan, whatever his financial prospects and circumstances, it is manifest that the banks will not take on the job without some underwriting by the Government. This has evident public expenditure implications, and implications too for relations between the Government and the banks. You will recognise that I shall need a lot of help from the Treasury in this area, including a willingness to lean on the banks' representatives to deal speedily and authoritatively with questions we may need to address to them.

Among the other matters on which we shall need to consult and which will feature in the options is liability for the payment of tuition fees. There is also the vexed question of the parental contribution (which we must assume to be likely to continue) and the need to open up for discussion the potentially conflicting interests of the student, his family and the taxpayer. Another area which will come under scrutiny in the review is the interrelationship between student grants and certain benefits which is already being examined by officials under DHSS chairmanship.

Given the intrinsic complexities of student support, the interactions with other issues of concern to Government, the many permutations of arrangements which might be displayed for illustrative purposes, and also the specific Scottish and Northern Irish dimension (mandatory awards in Wales lie with my Department): the timetable I sketch in para 3 above is actually a tight one and we shall do well to achieve it. Yet many will criticise it as slow, as happened when I indicated my hope for the timing of the Consultative Paper to the Select Committee for Education, Science and the Arts (ESAC) before whom I appeared earlier this week. I hope therefore that I may look to you and other colleagues concerned to provide all the support you can to enable us to make progress and to respond convincingly to the ideas which will be put to us in the course of the review. I have asked my officials to draw up a first draft of a Consultative Paper, and to aim to circulate this for consideration to the other Departments most closely concerned next month.

What I said to ESAC has been reported in the press this week. I propose, however, to confirm the prospective timing of the review and to announce the terms of reference through an arranged Parliamentary Question after the Christmas recess.

I am copying this letter to the Prime Minister, to Norman Fowler, George Younger, Douglas Hurd and other colleagues on H Committee, to Tom King and David Young, and to Sir Robert Armstrong.

Ever,

Keith

File

Kate Charlesworth

SIR KEITH'S NEW POVERTY TRAP

HERMIONE PARKER

Yet again, the government has aimed its guns at the wrong target, wantonly sacrificing the living standards and self-reliance of middle-income families and their student offspring on the altar of selectivity. Sir Keith Joseph's decision to abolish what remains of minimum student grant, to increase parental contribution rates for the second year running, and to introduce a new contribution towards tuition costs from "those most able to pay," highlights the urgent need for a less doctrinaire approach to policy making, and for all policy which concerns income maintenance to be brought under the control of a single government agency.

Most families affected by the new regulations—at any rate as proposed—can by no stretch of the imagination be described as rich. Some are living at less than 50 per cent above supplementary benefit levels. Yet they are being ruthlessly penalised by a Department of Education which has simply not done its sums properly.

Unless there's a change of tack, the regulations apply to the academic year 1985-86. Parental contribution rates will be 14 per cent on residual incomes above £8,100; 20 per cent on residual incomes above £10,300; and 25 per cent above £15,000. In this context, residual income means gross (taxable) income less mortgage interest, superannuation premiums and so forth, but before deduction of income tax and NI contributions. A flat rate amount (currently £80) is deducted from the parental contribution for other children.

Since the proposed maximum contribution is capped at £4,000 those worst affected will be families earning between average and 2½ times average earnings. Some will be two-earner families, where each spouse has a low wage. Others will be retirement pensioners. Wealthy families may be able to circumvent the regulations by using "granny" covenants. But most middle-income families have no wealth except the house they live in and their pension rights. The new regulations will cause hardship and will narrow the incentive gap between earning and not earning. Marginal tax rates will be pushed up to between 64 per cent and 79 per cent. Higher if there is entitlement to rate rebates.

Since 1962, when mandatory maintenance grants for first degree courses were introduced, the criteria for entry to higher education have been hard work and ability. Now, almost without warning, we seem to be moving towards the American system, where money counts more than aptitude. If the regulations go through, there seems little doubt some children from large families where the parents are caught in Sir Keith's new "poverty trap," will be prevented for financial reasons from entering higher education. This is a major policy change. Yet there seemed little intention to let parliament amend it. Last year's Education (Mandatory Awards) Regulations were not laid before the House of Commons until 1 August this year, and were not debated until 30 October, that is several weeks *after* they had taken effect.

Sir Keith's decision undoubtedly reflects the government's determination to make more effective use of public funds, and few would quarrel with that objective. But his tactics are dangerously wrong and his timing could prove disastrous. For while the Department of Education has been busy putting more selectivity into student grants, the Department of Health and Social Security has been equally busy looking at ways of putting more selectivity into child benefit. Between the two they look set to push marginal tax rates above the rates inherited by Margaret Thatcher in 1979.

Deciding which families are "most able to pay" is clearly outside the competence of the Department of Education acting on its own. In reply to a recent written question by Tony Marlow, the Conservative MP for Northampton North, who tried to discover what slices of after-tax incomes would be preempted by the new parental contributions, the minister replied that "the department does not collect information on the tax and national insurance payments of the parents of mandatory award holders."

Yet it is precisely the greatly increased taxation of families with children since 1962 which has reduced their ability to pay maintenance costs. Before 1962, parents could set the costs of higher education against a child tax allowance, which was higher than single person's tax allowance—about £2,145 in current terms. This age-related child tax allowance continued after 1962, though reduced in value, until taxable family allowances and child tax allowances were replaced by tax-free child benefit in 1979. Since child benefit stops at 19, the minimum student grant was increased from £80 to £385. Likewise the parental contribution rates were amended to take account of the lost tax allowance. Now all seems set for parents and students to lose minimum grant *and* the reduced rates of contribution *as well as* the tax allowance.

Is ability to pay quantifiable? In absolute terms—and without American or continental-style family budget estimates of basic needs and costs—the answer is probably not. But in relative terms, by comparing the net spending power of families of different sizes at different earnings levels with their estimated spending power on supplementary benefit, the answer is emphatically Yes. And it is a most necessary exercise. Without it, increased benefit selectivity, especially when superimposed on high taxes, becomes all too easily a euphemism for pauperisation, as wage and salary earners opt out of a system which penalises effort.

Net spending power in this context means the amount of money left each week from earnings or supplementary benefit, after adding in child benefit and after deducting income tax, national insurance contribution, housing costs and work expenses. Unlike the Department of Education parental contribution scale, supplementary benefit takes into account both the number and ages of dependent children. Rent or mortgage interest, rates and water rates are paid in full with SB. If one also adds 20 per cent to the SB scale rates to allow for "passport benefits" (for instance free school [illegible]als), single payments, additional requirements and disregarded income, then net spending power on supplementary benefit is approximately as shown in table 1.

Supplementary benefit is Britain's unofficial poverty line. It is imperfect, but it is the only measure we have. In America—where welfare scales are based on detailed family budget estimates of the baskets of goods necessary to provide different living standards—a second standard, called the "modest but adequate" level, is drawn at twice the poverty line. The American affluence threshold is defined as five times the poverty line. Those families living above the poverty line, but below the "modest but adequate" level, are described as out of poverty but "hard-pressed."

Table 1: Estimated net weekly spending power on SB, December 1984 rates

Married couple plus:	£
1 child, aged 17	75
2 children, 17 & 15	93
3 children, 17, 15 & 13	110
4 children, 17, 15, 13 & 11	127

In Britain, Sir Keith's new tapers will cut in on living standards below twice SB level, in other words on families in the hard-pressed zone. The relative prosperity of those families depends on many variables—for instance, the age and number of children, size of the mortgage, rates and water rates, and the costs to the parents of getting to work. The figures are complex, but the overall picture is clear. Families who are mortgagees, and who have more than two children, are already dangerously close to SB levels, unless they have earnings comfortably in excess of £15,000. None come anywhere near the affluence threshold. Table 2 shows how it comes about.

The £8,856 left from earnings of £17,000 works out at £170 a week, which is 183 per cent of the family's estimated poverty level. Parental contribution cuts the weekly amount to £151, or 162 per cent of the poverty level. These figures take no account of the student, whose grant, even if made up in full, is below supplementary benefit level if one takes into account the costs of books and travel.

Table 2: Net spending power—married couple with 2 children aged 17 and 15, all in full-time education. Husband earns £12,000, wife earns £5,000. Mortgage £25,000

	£
gross earnings	17,000
+ child benefit	688
– income tax	2,802
– national insurance contribution	1,530
– mortgage interest (at 10%)	2,500
– rates and water rates	500
– work expenses	1,500
= net spending power	8,856
– parental contribution	1,014
= residual spending power	7,842

Table 3 sets out the spending power position of families before and after application of the proposed maximum parental contributions. The figures take five earnings levels between £25,000 and £10,000, and assume three different mortgage levels. Superannuation premiums are excluded for the sake of simplicity. Rates are assumed to be £500, and work expenses £1,000. Only the father is earning. With earnings below £20,000, the families are living at less than twice supplementary benefit level, even before paying the parental contribution, which then drags more of them down into the hard-pressed zone. It can be deduced from the figures that larger families are likely to be charged parental contribution on incomes *below* the poverty line.

It is important to emphasise that these are all hypothetical families. In real life some will be better off and some worse off than the figures suggest. Superannuation premiums, for instance, will reduce the spending power of many families.

The National Union of Students estimates there are about 383,000 student award holders, of whom 183,000, or 48 per cent are likely to be affected by the new regulations. The department estimates that in 1985–86, some 75,000 families will be affected by the 20 per cent tapers, and 85,000 by the 25 per cent tapers as well. We are talking therefore of successive cohorts of nearly 200,000 families who will be caught for at least three years in Sir Keith's new version of the poverty trap. Because of high marginal tax rates plus the new parental contribution rates, it is a trap from which there is almost no escape. A non-earning spouse who tries to help out by taking paid employment will lose at least 64p out of each extra £1 earned. In some cases (where the family's income tax rate is pushed up to 45 per cent), the total net gain from each extra £1 will be only 21p.

Likewise the student offspring of "rich" parents are less able than their peers to top up spending power by taking part-time or vacational employment. Student grants do not count as part of taxable income, so students on the full award can earn a further £2,005 without liability to income tax. But students whose parents finance their contribution through a deed of covenant forfeit all or part of their personal tax allowance. As a result of the new regulations, there will be many more students who are liable to tax at 30 per cent on all their earnings.

What is the solution? Various options exist. The West German system of loans and means-tested grants (guaranteed by government if the parents default), plus educational tax reliefs for the parents, has much to commend it. A completely new approach would be through basic incomes or social dividend reform. The Basic Income Guarantee scheme, which I costed for 1982-83, would provide every student living away from home with £28.90 a week plus rent.

Meanwhile, the first step must be to bring responsibility for all aspects of income redistribution under the control of a single government agency. Until this happens, no sensible solution is likely to emerge.

Hermione Parker's most recent publication was "Action on Welfare"
Next week Howard Glennerster and Julian Le Grand continue the debate on financing students

Table 3: Net spending power before and after parental contribution

Married man with 2 younger children aged 17 and 15, both in full-time education

annual earnings	mortgage £30,000		mortgage £20,000		mortgage £10,000	
	NSP from work	as % of SB	NSP from work	as % of SB	NSP from work	as % of SB
£	£	%	£	%	£	%
a. Net spending power (NSP) before application of parental contribution						
25,000	269	289	280	301	291	313
20,000	208	224	222	239	235	253
15,000	142	153	156	168	169	182
12,000	—	—	117	126	130	140
10,000	—	—	—	—	107	115
b. Net spending power after paying maximum parental contribution						
25,000	214	230	220	237	226	243
20,000	177	190	186	200	194	208
15,000	132	142	142	153	151	162
12,000	—	—	114	123	124	133
10,000	—	—	—	—	107	115

NB: No parental contribution is payable in the case of £10,000 annual earnings with £10,000 mortgage.