PO-CH/NL/0224
PART B

Part B.

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(Circulate under cover and notify REGISTRY of movement)

Begins: 24/11/87.

Ends: ~~28~~ 4/~~1~~ 2/~~88~~ 88.

PO -CH /NL/0224

PART B

Chancellor's (Lawson) Papers:

REVIEW OF STUDENT SUPPORT

Disposal Directions: 25 Years

D Anderson

15/9/95.

PO -CH /NL/0224

PART B

pwp

FROM: MISS M P WALLACE
DATE: 24 November 1987

MR CROPPER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Gilmore
Mr Burr
Mr Tyrie
Mr Call

STUDENT LOANS

The Chancellor has seen your minute of 23 November, attaching an "Economist" article on the American experience of student loans. He has commented that this is certainly not a good system.

MPW.

MOIRA WALLACE

42/2 4368/7vj

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FST
TO
CH.EX
24.11.87

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 24 NOVEMBER 1987

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Culpin
Mr Tyrie
Mr Jenkins OPC
Mr Isaac IR
Mr Corlett IR
Mr Steward IR
PS/IR

BUDGET STARTER 150: MAINTENANCE PAYMENTS AND COVENANTS

I have discussed with officials the various papers on this subject ahead of your meeting tomorrow. This note sets out my recommendations.

Maintenance: Monetary Limit **(Mr Stewart of 13 and 20 November)**

2. I agree with you that the three options for the cap on the relief for the payer should be :

Option 1: £1,370
Option 2: £2,425
Option 3: £3,795

(ie. for Option 3, the MCA rather than the rough equivalent of the supplementary benefit rate for an adult, plus average housing costs).

3. In my view any of these could be defended:

Option 1: gives the single divorced man making maintenance payments of £1,370 or more the same tax relief as the married man supporting his wife (and children).

Option 2: gives the single divorced man making maintenance payments of £2,425 or more the equivalent of the single person's allowance to set against these payments to his ex-wife.

Option 3: gives the single divorced man making maintenance payments of £3,795 or more the equivalent of the married couple's allowance to set against the maintenance payments.

4. I think that whilst all three options are defensible the first two are perhaps - in strict logic - the easier to defend. Option 3 would give the re-married divorced man maintaining his ex-wife the equivalent of three single allowances. This looks a little too generous. In choosing between Option 1 and 2, we cannot ignore the fact that an estimated 24 per cent of those paying maintenance would get less relief with a cap of £1,370 than they would under the current regime. I therefore favour Option 2 - a compromise between logic and pragmatism - under which only 7 per cent of maintenance payers would be "worse off".

5. But I think it needs to be stressed that the estimated number of losers does not take into account behavioural effects. Under the new regime one can expect the courts to be more reluctant to grant Orders for amounts above £2,425 pa. Doubtless there will be some recipients of maintenance payments who will get less - even allowing for the tax-free nature of the payments - than they would have done under the existing regime.

Maintenance: Children (Mr Isaac of 20 November)

6. I have examined whether there is some half-way house under which it might be possible to allow tax relief for payments made to children where those children are living not with an

ex-wife or with the supporting male but with a "third-party". I think we can fairly argue that where a child is living with the divorced wife the tax relief should be confined to payments made to her. But, as Mr Isaac highlights, if the child is not in the custody of either father or mother, then our current (12 October) proposals will throw up some hard cases.

7. It seems to me that it would be possible to confine relief for payments to children purely to the situation I have described - where the children are living with neither the father nor the mother. However, this would be a thin line to have to defend. We would have a tangled situation in which:

- tax relief is available for payments made to a divorced or separated wife, so that she can maintain herself and the children;
- tax relief is available for payments made to children living with "third parties" (grandparents, friends or whoever);
- no tax relief is available for payments made to an unmarried mother living alone for the maintenance of her children.

8. On balance I would prefer to stick to our original conclusion that all maintenance payments to children should be ineffective for tax purposes.

9. I suspect that the most vociferous opposition to this proposal will come from the one-parent family lobby. We will be making ineffective for tax purposes a large number of affiliation orders (which are, of course, a major tax benefit for the unmarried). It is quite right and entirely defensible to do this when unmarried couples live together. But different

problems arise with unmarried mothers living on their own. The effect will be to make worse off a significant number of unmarried families. We may have to consider whether the available benefits for one parent families (and the successor to the Additional Personal Allowance) need to be made more generous.

Maintenance Payments: General **(Mr Stewart of 20 November)**

10. I agree with all the recommendations in Mr Stewart's minute; in particular that:-

(i) There should be one ration of relief however many ex-wives the husband has.

(ii) Relief should be confined to payments under legally enforceable Orders or agreements.

(iii) Subject to an examination of any EC angles, payments under foreign orders and agreements should not qualify.

(iv) The suggested transitional arrangements are acceptable.

Covenants: General **(Mr Stewart of 20 November)**

11. I think that most of the recommendations in this note are sensible:

(i) The new rules should apply to covenants made on or after Budget Day.

(ii) Relief on pre-Budget covenants should continue indefinitely.

(iii) "Formula increases" in payments under pre-Budget covenants should be allowed where they would get relief under the present rules.

(iv) Pre-Budget covenants should be required to be submitted to the Revenue by 30 June 1988 if they are to qualify for continuing relief.

12. The question of compensation for students is rather more complex. We are agreed that we need to use the money saved by abolishing tax relief for student covenants to reduce parental contributions. In the transitional period, however, since tax relief will continue for those with pre-Budget Day covenants, we will not be able to compensate fully the "new" students unless we inject extra resources into grants. This follows from the fact that not all the tax relief will be saved in the short-run.

13. I do think we have to err on the side of generosity on this issue and I would therefore support the option in paragraph 15 of Mr Stewart's note. This means giving those with pre-Budget covenants the benefit of the "new" parental contribution scales. For the majority of cases this generosity will be extended for a maximum of three years. But I prefer this to the much more complicated option of having two separate scales in operation for a transitional period.

14. I think we need to discuss the appropriate level for the "new" parental contribution scales with Treasury officials. But my own view is that whatever level we think we can afford should be available not just to "new" students but also to those with pre-Budget covenants.

NL

NORMAN LAMONT

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART
DATE: 24 NOVEMBER 1987

1. MR ISAAC 24.11

2. CHANCELLOR

MAINTENANCE AND COVENANTS

1. An annotated agenda is attached for your meeting on this subject tomorrow.

Costings: covenants

2. For covenants, the most recent cost of tax relief is well over £m200. We are currently processing the results of a sample survey carried out to update our estimates, and revised figures should be available shortly. Assuming that pre-Budget covenants would continue to get relief, the tax yield from withdrawing relief would come in only gradually.

3. On the public expenditure side, the costs will depend on whether the full saving on tax relief for student covenants (or more, or less) is ploughed back into student support. Exact compensation is difficult to achieve, because some students have a grant but no covenant, or vice versa, and the Revenue does not collect information about grants in individual cases. The method by which the savings

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Burr
Mr Cropper
Mr Tyrie
Mr Jenkins (OPC)

Mr Battishill
Mr Isaac
Mr Corlett
Mr Lewis
Mr Beighton
Mr Calder
Mr Easton
Mr Mace
Mr Davenport
Mr R H Allen
Mr Yard

Mr J C Jones
Mr Martin
Mr Eason
Mrs Fletcher
Mr Stewart
PS/IR

should be recycled will also need to be considered - whether the aim is to compensate the individual parent/student as closely as possible for loss of tax relief, or to distribute the money in a different way.

4. Once updated figures for the tax saving are available, it will be necessary to discuss this with the Treasury.

<u>Costings: maintenance</u>

5. On maintenance, the eventual <u>tax costs</u> are estimated tentatively at

£2,425

Option 1 (£1,370 limit) - £m20 yield;
Option 2 (£2,500 limit) - £m 5 cost;
Option 3 (£3,250 limit) - £m10 cost;
(£3,795 limit) - £m15 cost.

£10m [illegible]

6. We are hoping to obtain further data from the Family Expenditure Survey and an OPCS survey which may help to refine these figures.

7. The transitional arrangements will affect the revenue effects in the early years. The kind of election referred to in paragraph A 9c of the agenda would <u>increase</u> the revenue cost in the transitional period, since gainers from the new rules would elect, but losers would not.

8. <u>Potential losers</u>. My note of 13 November (paragraphs 11-14) looked at the numbers and proportions of people who are paying maintenance at various levels and who would therefore stand to lose from a limit on the relief. I should however record one qualification to the figures, which we are following up. The Financial Secretary's minute of today highlights the position of unmarried couples where the maintenance payments will be for the children's maintenance rather than a "wife". The figures quoted in my note include some unmarried people as well as divorced or separated husbands' paying maintenance. Our present data does not record these two types of payers separately. But to the

extent that the payers are unmarried - and are thus likely to lose relief even if their payments are below the limit for "divorced" relief - the numbers and percentage of losers may be slightly higher than the figures I quoted. We are doing further work to try to get better estimates of the likely numbers of losers divided between the divorced/separated (where the numbers should still be relatively small) and the unmarried.

9. On the public expenditure side, there would be some knock-on effects on take-up of social security benefits. We cannot put a figure on these without consulting DHSS. Most low-income divorced or separated couples would pay the same or less tax; but some could pay more (and thus need extra benefits). Unmarried mothers could also qualify for extra benefits, depending on the treatment of maintenance for their children. If there is no relief for payments for the children of unmarried mothers, some unmarried mothers who receive less maintenance will need more social security benefit. On the other hand, making the maintenance tax-free for recipients would encourage some of them to go out to work (and have their full personal allowance to set against earnings); so some might be less dependent on social security benefits.

CS

C STEWART

MAINTENANCE AND COVENANTS: AGENDA FOR CHANCELLOR'S MEETING 25 NOVEMBER

A: MAINTENANCE

Papers - Mr Isaac's note of 20 November to Chancellor.

- Mr Stewart's notes of 13 and 20 November to FST
- Mr Stewart's note of 20 November to Chancellor
- FST's note of 24 November.

1. Ministers provisionally agreed (12 October meeting) that

- a limit should be placed on tax relief for maintenance payments to divorced/separated spouses
- payments should be tax-free for the recipients
- maintenance payments to all children should be made ineffective for tax.

2. The relief would cover payments, up to a limit, to a divorced or separated spouse once married allowance was no longer due in respect of her.

The monetary limit on relief

single - £75m
or married - £115m

3. Where should the limit be set? (Mr Stewart's note of 13 November illustrates 3 limits - £1,370, £2,500 and £3,250; note of 20 November to FST costs a £3,795 limit). FST favours £2,425 (equal to single allowance).

✓

4. Is it agreed that the limit should not be doubled for someone who has two ex-wives (and so on)?

Children

5. The treatment of payments to/for children raises some sensitive issues (Mr Isaac's note of 20 November), eg stopping relief for the husband when the divorced wife dies and grandparents take custody of the children. On the other hand if relief is extended to some children's maintenance, there are other problems and anomalies - eg between the married and the divorced, and with unmarried couples. Should relief for all maintenance payments to children be stopped ~~denied~~ (as provisionally agreed on 12 October)? FST favours this. If not, where could or should the line be drawn between qualifying and non-qualifying payments to children?

yes

General points

6. Should there continue to be no relief for

a. voluntary payments (ie those not made under a Court Order of legally enforceable agreement)?

b. payments under foreign Court Orders or agreements?

FST agrees on both (subject to considering any EC aspects of b).

yes

Transitional arrangements

7. Should the new rules apply to Orders/agreements made on as well as after Budget Day?

yes

8. Should relief continue to run without time limit to pre-Budget Orders/agreements?

yes

9. Three modifications to the general rules at 8 above are suggested for consideration:

a. to avoid problems for the Courts immediately after Budget Day, should we pursue the possibility of allowing the old rules to apply where an application was made to the Court before Budget Day and the Order made within (say) 3 months after Budget Day?

b. where a pre-Budget Day Order/agreement is superseded or varied by a new Order/agreement after Budget Day, should the new rules apply to the new Order? (Where a separate supplementary agreement is made after Budget Day, the old rules would however continue to apply to the original pre-Budget Order/agreement.)

c. some couples with pre-Budget Orders etc would gain by switching immediately to the new rules, but some would not. Should couples be allowed to elect to switch, provided both partners wish to do so?

10. Should pre-Budget agreements have to be submitted to the Revenue by (say) 30 June 1988 in order to get the benefit of the old rules? (This would reduce the scope for deliberate backdating; it need not apply to Court Orders.)

11. FST agrees with these recommendations on transitional arrangements.

B: COVENANTS

Papers - Mr Stewart's note of 20 November
- FST's note of 24 November (paragraphs 11-14)

1. Ministers agreed that in general new covenants between individuals should be made ineffective for tax purposes - 12 October meeting paragraph 10(i) and (ii). There would be transitional arrangements for existing covenants.

General

2. Should the new rules apply to covenants made <u>on</u> as well as after Budget Day?

yes

3. Should relief for pre-Budget covenants

a. continue indefinitely, or be limited to a fixed period (eg 6 years)? FST favours no limit.

agree

b. apply to increased payments resulting from the automatic application of a formula already built into the covenant? FST agrees

yes

Students

4. Ministers intended that compensation should be given to students through the student support system. Revenue are currently updating estimates of cost of covenant relief (from a fresh survey); and will need to discuss possible options and their costs with Treasury - ie how much extra support would withdrawal of covenant relief finance and in what form should it be given.

NB.

5. <u>Transitional</u> problem concerns students with pre-Budget covenants. Their covenants will continue to get relief. Should they get increased grant support at the same time? This is simpler but is generous and involves extra costs on grants. FST favours this approach, subject to considering the figures with Treasury officials.

much simpler

6. If that approach is not adopted, should the grant system differentiate between students with pre-Budget covenants and other students - ie two grant/contribution scales? Should students with pre-Budget covenants then have an option to renounce their covenants and qualify for improved "new scale" grants? (If so, procedures to be worked up in more detail by Revenue. In due course, consultation with DES may need to be considered.) FST regards this as too complicated.

7. Another possibility* might to stage the increase in grants, to reduce the cost. So a new student in year 1 would get no covenant relief and only the "lower" increased grant. But grant might reach "full" increased level in year 2. Should Revenue do more work on this Option?

yes

* A variant of the para 5 option. It implies 'first year' losers, but a lower Exchequer cost in that year.

[illegible]

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FROM: S P JUDGE
DATE: 25 November 1987

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Sir Peter Middleton
Mr Cassell
Mr Scholar
Mr Culpin
Mr Gilmore
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
PS/Inland Revenue
Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR

MAINTENANCE PAYMENTS AND COVENANTS: STUDENT SUPPORT

The Paymaster General has seen the papers for the Chancellor's meeting this afternoon. He has two comments.

First, he thinks that two scales of parental contribution would be a nightmare, in what is already a complicated system with high peaks of workload for LEAs for limited periods of the year. There would be a major reaction from the local authorities, but on top of that the student grant correspondence from MPs to whoever does Mr Jackson's job already exceeds by a wide margin anything that the Paymaster has been subjected to at the Treasury.

Second, the Paymaster would like reassurance that by making covenants to students ineffective for tax purposes we are not going back to a system as regressive as the old minimum grant regime - on whose dismantlement a fair amount of emotional energy was spent.

SPJ

S P JUDGE
Private Secretary

STUDENT COVENANTS

CONFIDENTIAL

pmp

Ch

you wanted to discuss with PMG.

mpw. 3/12

A J G Isaac CB
Deputy Chairman

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE
LONDON WC2R 1LB

Telephone 01- 438 6604

27 November 1987

P Cropper Esq
HM Treasury

Discuss w.

Bayers?

Dear Peter,

STUDENT COVENANTS etc

At the end of the Chancellor's meeting there was a very brief discussion of the Paymaster General's anxieties, whether the proposals meant that DES would be reverting to a "regressive" minimum grant for students.

The direct answer, which both Mr Burr and I gave, was to the effect that the proposals did involve the reintroduction of a minimum grant; but the intention of this was so far as possible to maintain the present income distribution. Covenants under the present system are used, very broadly, to attract tax relief for the parental contribution to student maintenance (obviously, some do less than this; and some do more, so as to give more than the basic maintenance grant). The Chancellor's previous meeting had agreed that compensation should be given on the broad lines sketched in by Mr Burr's Option 3. As a result, the means test for student maintenance grants would be less steeply progressive (as such), and there would be a new minimum grant; and this would match (very broadly) a correspondingly progressive withdrawal of tax relief from the parents' covenants.

On reflection, it occurs to me that the Paymaster General may have had in mind some earlier events in this field, which I recall having mentioned at previous Ministerial meetings, but which have not been brought back on to the table recently. As you will remember, child tax allowances were withdrawn in the late 1970s. For children up to school leaving age, these were replaced by child benefit. Consistently (as I recall it) with earlier discussions on the tax credit system, child benefit was not extended to children at university or polytechnics. Instead, compensation was given in the form of a new "minimum grant" for

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students (the compensation was made explicit in the Written Answer from the then Secretary of State for Education on 28 March 1977). Subsequently, the "minimum grant" was withdrawn, partly to save money and partly (I believe) to target student support more closely on low income families.

I thought to send this note to you, rather than formally to Ministers, because the point is essentially a political one, not a policy one. May I leave it to you, if you think it is something which should be taken further?

yours ever

A J G ISAAC

cc Principal Private Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Mr Burr
Mr Battishill
Mr Isaac
Mr Corlett
Mr Stewart

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
22 December 1987

1. MR ISAAC ACI 22.12

2. FINANCIAL SECRETARY

This is admirably comprehensive and lucid – this is just to explain what the problem is. But we will also need a simpler, brisker, presentation drawn on a positive exposition of the new system –

MAINTENANCE AND COVENANTS: PRESENTATION

1. Following the Chancellor's meeting on 25 November, we attach a note which sets out a first shot at the presentation of this package of measures. It has been prepared in conjunction with Treasury officials.

2. It can be polished up as we go along. But it would be helpful to know whether you are happy with the general approach. Paragraphs 1 to 8, which are largely the work of Mr Hudson, are designed to bring out the bull points - for example in the context of the Budget Speech. The remainder of the note fills in more of the background, and includes more detail about the benefits of simplification as well as defensive material.

C W CORLETT

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
Mr Battishill
Mr Isaac
Mr Beighton
Mr Stewart
Mr Davenport
Mrs Fletcher
Miss Sprowl
PS/IR
Mr Corlett

PRESENTATION OF MAINTENANCE/COVENANTS PACKAGE

Introduction

1. The present tax treatment of maintenance payments and covenants is extremely complicated, and leads to serious anomalies and unfairness. Recent Court decisions have raised new uncertainties. And, in any case, the rules need changing to fit in with independent taxation.

2. There is to be a major reform which will create a fairer and simpler system.

3. Existing maintenance arrangements and deeds of covenant will be unaffected.

4. Nor will there be any change in tax relief for future charitable covenants. The encouragement of charitable giving remains fundamental to Government policy.

The case for change

5. The vast majority of maintenance payments and non-charitable covenants are either divorced or separated men maintaining their ex-wives or children; or parents paying an allowance to their student children; or grandparents making payments to their grandchildren.

6. These are straightforward everyday situations. On the face of it, there is no reason for the tax system to get involved. Married men do not get relief for maintaining their wives and children, beyond the married man's allowance. And parents supporting their children in other ways do not get any relief.

7. But at present, the tax system adds to the complexity of these arrangements.

- Most maintenance payments are paid gross, and ex-husbands have to claim relief separately. And ex-wives, who are above the tax threshold, have to pay tax on the money. This makes work for the taxpayer and the Inland Revenue alike. And it is a disincentive for the wife who wants to go out to work.

- A further complication is that some maintenance payments are paid with tax deducted. In that case, where the recipient is not liable to tax, she has to get a repayment from the Revenue. This makes more work for all, and delays the time when the ex-wife or child gets the full amount of the money.

- For students, the parent will usually have gone through a means-test for the student's grant. He then has to go through the legal rigmarole of making a covenant, and supplying evidence of payment. The Revenue then have to means-test the student and repay him the tax relief. As covenant income is taxable, many students are discouraged from taking holiday jobs and paying tax on their earnings. It is difficult to imagine a more convoluted way of getting State support into the hands of students.

8. The system also penalises marriage. A few well-off, well-advised couples can save many hundreds of pounds of tax by living together

unmarried, covenanting to each other, and, if they have children, also getting relief for the cost of maintaining and educating them. And the Sherdley case has opened the way to further unfairness, by allowing a divorced parent tax relief for the cost of educating his children who are living with him. Unless the Courts extend the Sherdley precedent still further, the only bar to parents obtaining tax relief for the cost of maintaining their children will be to get married and stay married.

Proposals

9. The Government proposes a radical simplification. Relief will continue to be available up to a certain limit for payments to divorced or separated wives in recognition of the fact that there are two households. Other new maintenance payments and covenants will be taken out of the tax system altogether.

10. In practice, this will mean -

- divorced and separated wives, and students, will no longer have to pay tax on future maintenance or covenant receipts;
- relief will be available to payers up to a certain limit for maintenance payments to divorced and separated wives;
- no tax relief will be available for other maintenance payments;
- there will be no tax relief for payments under future covenants (except for payments to charities);

- parental contribution to student grants will be reduced, for new students, to reflect the absence of tax relief.

- [other Social Security/OPB consequences.]

11. This is an opportunity to make the tax system fairer and a lot simpler. Tax complications are being swept away; relief will target more closely on the recipient rather than (as now) on the payer. In future support will be given, where it is needed, in a more sensible way: by a measure of tax relief for maintenance payments for ex-wives; by reduced parental increases contribution to student grants for students; by additional social security benefits to single parents; by making the payments tax free in the recipient's hands.

<u>Simplification</u>

12. Radical simplification will bring widespread benefits -

- <u>Ordinary people</u> will be able to understand the system. At present, covenants are often couched around with unintelligible legal mumbo-jumbo which can trip people up so that they do not get the tax relief they expected. In the case of maintenance, there are three different systems at present and this is confusing.

- Divorced and separated wives, unmarried mothers, students etc will not have to report their maintenance or covenant receipts to tax offices. Will be able to earn up to single personal allowance, without coming into tax.

- Many students will receive [more of] their support directly through grants, instead of (as now) partly from local authority grants and partly indirectly via the tax office.

- Many unmarried mothers will receive more of their support directly from payments to them than (as now) indirectly from the tax systerm.

- The Courts, will not be required to waste time on making Orders designed simply for tax avoidance purposes.

- Tax practitioners, will find the tax affairs of many of their clients easier to handle.

- The Revenue, will save up to [ ] staff.

Greater fairness

13. For married couples. Widely recognised that the present availability of covenant and maintenance relief penalises marriage. Clearly wrong that couples who marry should be entitled to substantially less tax relief than is available to unmarried couples. For example, unmarried couples living together can, by covenanting to each other, get tax relief well in excess of the married man's allowance. And, if they have children, they can get tax relief for the cost of maintaining and educating their children, whereas there no such relief for married couples.

14. Sherdley case has opened the way to further unfairnesses, and extended the maintenance relief well beyond its original intentions - eg by giving relief to a divorced father for maintaining and educating his children living in his own home, so that only those who are and remain married get no relief for children. General expectation amongst tax specialists that the Government must put the law on a more satisfactory footing as soon as possible.

15. Changes correct those anomalies. And are consistent with the Government's policy of fostering family life.

16. For less well-off. Will end system under which better-off and better-advised can reduce tax arbitrarily and unfairly - and by sizeable amounts - through covenants between members of a family (eg grandparents to grandchildren) or between friends. In the context of the Budget package, these reliefs have lost any justification they may once have had.

17. Also for the less well-off, the new system will end the earnings trap under which students with covenants and separated or divorced wives may now pay tax on every pound of earnings because their personal allowance has already been used up against the covenant or maintenance payments.

18. Discourage evasion. Covenant relief tempts illegality - eg claiming relief on reciprocal payments (A covenants to B's child, and B covenants to A's child). The scope for this ended.

19. Tax rates down. Withdrawal of relief - particularly the covenant relief - will produce a

modest yield to the Exchequer [ ] contributes to Chancellor's overall policy of ending special privileges and getting the main tax rates down for everyone.

Protection for existing arrangements

20. Relief for existing covenants/maintenance not affected. No-one with an existing covenant or maintenance order will lose relief. Arrangements drawn up before Budget Day will be allowed to run on for as long as they legally apply.

21. All new maintenance and alimony payments will be free of tax in the hands of the recipient. So they will be treated exactly like housekeeping given by a husband to his wife.

New arrangements for support

22. Charities: Relief for covenants to charities continues unaffected.

23. Some relief for maintenance payments to divorced or separated wives. A limit - equivalent to the single person's allowance - is being placed on the amount of tax relief available. This reflects the additional cost of maintaining two households.

24. Students to be compensated by [increase in grants].

25. Unmarried mothers (and people looking after another person's child) to be compensated by [ ].

Pressure points

26. These will depend to some extent on how the details of the reform are settled, but could include:

- Will relief for charitable covenants be next to go? No, the Government remains fully committed to its tax reliefs for charities.

- Why pick out divorced and separated wives for relief, even where there are no children, when payments to unmarried mothers living on their own, or to third parties caring for children, will get no relief? The relief for divorced and separated wives reflects the fact that there has been a marriage and the special obligation on a man to maintain his ex-wife.

- Why limit the relief available on maintenance to divorced and separated wives? Fair to give divorced/separated men relief to reflect additional cost of maintaining two households. But clearly inconceivable to allow payer unlimited relief and make payments tax free in hands of recipient.

- Does this reverse the House of Lords' decision in the Sherdley case? Yes, but rationalises the law, as the House of Lords implied should be done. In future, only maintenance payments to wives will qualify for relief, and then only up to a limit.

ps3/44T

CONFIDENTIAL

PMP

FROM: J M G TAYLOR
DATE: 31 December 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
PS/IR

MAINTENANCE AND COVENANTS: PRESENTATION

The Chancellor has seen Mr Corlett's submission of 22 December.

2. He thinks this is admirably comprehensive and lucid, though it will need to be revised to explain what the Sherdley problem is. But we shall also need a simpler, briefer, presentation based on a positive exposition of the new system.

JT

J M G TAYLOR

CHANCELLOR OF THE EXCHEQUER

C,

1. Since I was involved in an earlier stage of this, Clive Corlett asked me to have a go at meeting your request on this. That I think I can do, once time permits.

2. I'm less sure about the FST's ideas (below), but we will think about all this. I'll also get Robert's views.

A[illegible]

8.1

Mr Rankin: Alex will carry this [illegible] tell you [illegible] [illegible]

42/2.BTW.4373/20

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 4 January 1988

MR CORLETT IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
Mr Isaac IR
PS/IR

MAINTENANCE AND COVENANTS: PRESENTATION

The Financial Secretary was grateful for your minute of 22 December.

2. The Financial Secretary has commented that the problem about presenting all this is that although there are common threads, the arguments for changing the present system in respect of ex-wives, grandchildren, common law wives, illegitimate children and students are all a bit different. He thinks we need to split up the arguments, by category, since we are currently muddling them up and are dragging up points about marriage even where they are not strictly relevant.

3. The Financial Secretary thinks that the consistent themes are:

(i) Simplification;

(ii) In an era of reduced taxes these reliefs can go without hardship.

4. For example, the Financial Secretary was a little unhappy about the way the changes on maintenance payments were being presented. Paragraphs 5 and 6 seem to imply that we are removing tax relief for maintenance payments to ex-wives and children because married people cannot covenant to each other. It has nothing to do with discrimination against marriage. We are recognising that divorced people have extra obligations but giving the tax relief in a different way that is simpler.

5. The presentation also needs to emphasise that most people - those making small-sized maintenance payments and students - will be no worse off.

Susan Feest

pp.

JEREMY HEYWOOD
Private Secretary

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART

DATE: 7 JANUARY 1988

1. MR CORLETT

2. MR ISAAC

3. FINANCIAL SECRETARY

STEWART TO FST 7JAN

COVENANTS

1. At the Chancellor's meeting on 25 November on maintenance and covenant reform, it was confirmed that:

a. covenants made between individuals on or after Budget Day should not be effective for tax purposes; and

b. pre-Budget covenants would continue to get tax relief.

2. You asked for further work to be done on the implications for student support, including the transitional problems. This note on these points has been agreed with the Treasury.

---

cc
Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Beighton
Mr Calder
Mr Corlett
Mr Davenport
Mr Yard
Mr Golding
Mr Boyce
Miss Dougharty
Mrs Fletcher
Mr Stewart
PS/IR

Objectives

3. The broad idea is that compensation for withdrawal of covenant reliefs should be given by increasing the grants payable to students entitled to mandatory and full-value discretionary awards. This would be done by reducing the assessed parental contributions by the equivalent of basic rate tax relief (and giving a minimum grant where appropriate).

Question for Decision

4. The main point for decision is whether it is acceptable for existing students, many of whom will have pre-Budget covenants running on, to get a double benefit from the old (continuing) tax relief and the increased grants in the first two or three years. If it is not, the question then is what can and should be done about it.

5. Two important - but conflicting - aims here are

a. to minimise, so far as possible, any increase in the net Exchequer cost of student support during the transitional period. This would point to having some special provisions to restrict the double benefit;

b. to avoid complex arrangements for local authorities and the Revenue to operate. This would point against special provisions.

6. It is also important to avoid accusations of retrospection and bad faith by any compulsory withdrawal of tax relief for covenants already made before the Budget.

Numbers

7. The total cost of tax relief for student covenants is about £m150 a year. This - like the other figures in this note - is based on the present basic rate of tax. If the basic rate changes, the yield from withdrawing tax relief - and the cost of compensation through alternative student support - will change accordingly.

8. About 350,000 students now have covenants. DES statistics suggest that there are about 625,000 students in higher or further education. Over 500,000 of these are entitled to mandatory grants (or would be, but for their parents' income level), or receive discretionary awards related similarly to parental income. All these $^{1}/2$m students will in any event have their fees paid by local authorities.

9. Some students with covenants are not eligible for a grant, but the number is not known: the Revenue at present has no need to ask covenant claimants whether they receive a grant. Conversely, it is likely that some students with grants have no covenant. For example, about 115,000 students get full grants with no parental contribution. Some of these might have a covenant, but probably not very many.

10. This implies that whatever broad compensation is given for loss of covenant relief for students, there will inevitably be some individual losers and gainers amongst parents and students in future years. For example, if the student is on a course which is not eligible for a grant, there will be no covenant relief and no compensation. Students who do get a grant will benefit from the compensation whether or not the parent would have taken advantage of the covenant relief.

11. The proposal - to reduce the parental contributions by 27% for all mandatory and "full-value" discretionary award holders (and introduce a minimum grant of 27% of the present parental contributions) - is estimated to cost about £m115 a year. In terms of public expenditure, the £m115 would be a gross addition to the planning total. This is somewhat less than the total cost (£m150) of the present tax relief. It underlines the point that some people with covenants will have no grants, and some with grants will have covenants for more than the assessed parental contribution.

12. The cost of tax relief on <u>other</u> (non-student) covenants (mainly those to children under 18) will go down as pre-Budget covenants gradually run out. The estimated cost is:

	87/88	88/89	89/90	90/91	91/92
					(£m)
Cost	60	50	35	20	15
Saving on 87/88 cost*	-	10	25	40	45

* These are minimum savings, because we would expect the £m60 cost to increase if the rules remained unchanged.

The options

13. Broadly, there are three ways of approaching the transitional problem:

Option 1 - a clean switch from covenants to new grants in 1988

Option 2 - a clean switch in 1990

Option 3 - two grant scales running side by side for a period

Option 1: clean switch in 1988

14. Under Option 1:

- only pre-Budget covenants would continue, and
- the improved grants would be given from 1988-89 to all mandatory and full-value discretionary award holders, whether they had a pre-Budget covenant or not.

15. Some future students not eligible for grants would lose, because they would get neither grant nor tax relief. But assuming that parental contributions were reduced by 27% (and a minimum grant equal to 27% of the full grant was introduced), this option does as much as the grant system can do to minimise losers.

16. There would be many gainers during the transitional period, because students with pre-budget covenants would also get the improved grants.

17. The following table shows the Exchequer effects of Option 1:

	Financial year			(£m)	
	87/88	88/89	89/90	90/91	91/92
Cost of relief for pre-Budget student covenants	150	110	60	20	5
cost of increasing grants (by reducing contributions by 27%)	-	75	115	115	115
Total cost	150	185	175	135	120
Cost (+)/saving (-) over current student regime	-	+35	+25	-15	-30
Saving (-) on non-student covenants (para 12)	-	-10	-25	-40	-45

18. This option has a number of advantages:

a. there would only be a single grant/contribution scale, as now; so it would be simple for local authorities to administer;

b. the manpower savings for the Revenue would start to come through at an early stage. Savings on covenant work (including non-student covenants) would be 140 units in 1988-89, 250 in 1989-90 and 330 in 1990-91;

c. it should minimise opposition to the change from students and their parents.

19. Its disadvantages are that -

a. it has a net Exchequer cost of about £m60 in the first two years, partly offset by savings of about £m35 on other covenants;

b. the Treasury believe that the acceptance of an additional cost could encourage pressure from DES for more resources to be made available in the Review of Student Support. Specifically they might suggest that the fall in the cost of student support from the 1988-89 peak was unnecessary and that the higher level could be maintained.

c. there could be complaints that it was arbitrary to give some students both tax relief and a reduced parental contribution, but only the latter to others.

Option 2: clean switch in 1990

20. Option 2 would delay the switch-over for a couple of years. It would reduce the transitional cost of the student change, while still based on a single grant/contribution scale.

21. Relief for pre-Budget covenants would continue. But the improved student support would not be introduced until (say) the academic year 1990-91. By that time most, though not all, current students would have completed their courses. Most students would thus not get any double benefit from "old" covenant relief and improved support simultaneously.

22. But it would probably then be necessary to allow students to get relief for post-Budget covenants for the two years 1988-89 and 1989-90. Otherwise they would be worse off - a student would not be able to start a covenant after the Budget, but would not get the improved support until 1990.

23. But this delay would add complications:

i. for the continuing relief for new covenants, the legislation would have to define qualifying students, and it would be necessary to decide whether the facility should be available only for students eligible for grants, or for all students. Strictly it ought to be confined to those eligible for grants since it is only a transitional relief until grants are increased. Other students might well complain; but if the relief was extended to them, there could then be pressure for the covenant system to continue beyond 1990;

ii. there is also the awkwardness that new covenants would get relief for only 2 years. Under the present rules covenants have to be capable of running for more than 6 years. (Normally student covenants are worded so as to run for 7 years, or the end of full-time education, whichever is earlier; so in practice they come to an end before the 7 years are up.) There may also be problems over the mismatch between the tax and academic years.

24. Under Option 2 there would still be some net Exchequer cost, to the extent that pre-Budget students on long courses could get covenant relief and improved support simultaneously from 1990 onwards. But the cost would be much less than under Option 1:

	Financial year			(£m)	
	87/88	88/89	89/90	90/91	91/92
Cost of relief for pre-Budget student covenants	150	110	60	20	5
Cost of relief for new short-term covenants	-	45	95	20	0
Cost of new grants	-	-	-	75	115
Total cost	150	155	155	115	120
Cost (+)/saving (-) over current regime	-	+5	+5	-35	-30
Savings (-) on non-student covenants (para 12)		-10	-25	-40	-45

These figures include £m5 for increased take-up of covenant relief in each of the next two years.

25. It would not be necessary to decide now exactly what form the compensating improvement in student support arrangements would take. Possibilities include a reduction in parental contributions, an increase in the gross level of student grants (or loans), or a combination of both (on the lines set out in Mr Burr's paper of 18 September). The appropriate arrangements could therefore be settled as part of the Review of Student Support, and integrated with the new support regime. But if Ministers were not in a position to put forward specific proposals for new arrangements for student support, they would come under pressure during the Budget and Finance Bill debates to postpone the tax reform. The Treasury however envisage that the proposals emerging from the Review would need to be published around that time.

26. Option 2 would have the advantage of:

a. being simple for local authorities to operate (like Option 1);

b. opening up the possibility (unlike Option 1) of combining the change with any longer term proposals for reform of student support (if Ministers see that as attractive);

c. costing less than Option 1. As with Option 1 there would also be £m35 savings on non-student covenants over the first 2 years.

27. But it also has disadvantages compared with Option 1:

a. the Revenue manpower saving would be postponed by two years. Savings on covenant work (including non-student covenants) would be only 10 in 1988-89 and 50 in 1989-90; then 315 in 1990-91;

b. the cost of relief for student covenants might increase in the meantime, because publicity might lead to increased take-up while relief was still available. The table in paragraph 24 above makes a small allowance for this.

c. it would be more complicated than Option 1 because the tax legislation would need to provide for continuing relief for post-Budget covenants for students only (and not other individuals);

d. the 2-year delay runs the risk that opposition to the loss of covenant relief would build up by the time it was due to come into operation, so that the tax reform would in practice never happen. It would also distance the covenant reform from the compensating benefits of the overall Budget package.

Option 3: two grant/contribution scales

28. Option 3 is a way of making the change from Budget Day without a net Exchequer cost, by restricting so far as possible the number of students who could get both covenant relief and improved grants.

29. It involves having two grant/contribution scales. In principle, this could be tackled in a number of ways, but the simplest would be to give the new (improved) grants only to students starting courses after the Budget. Students already on courses would continue to get the old level of grants. This would avoid making the grant rate dependent on whether the individual student had a covenant. So the local authority would only have to determine whether the student was starting a course after the Budget.

30. The Exchequer effects of Option 3 would be as follows:

	Financial year			(£m)	
	87/88	88/89	89/90	90/91	91/92
Cost of relief for pre-Budget student covenants	150	110	60	20	5
Cost of increasing grants for new students only (by reducing parental contributions by 27%)	-	25	63	100	115
Total cost	150	135	123	120	120
Cost (+)/saving (-) over current student regime	-	-15	-27	-30	-30
Savings (-) on non-student covenants (para 12)	-	-10	-25	-40	-45

31. The <u>advantages</u> of Option 3 are that -

a. the transitional Exchequer cost is eliminated and there should be a small saving;

b. the Revenue manpower savings would start to come through in the first year - 140 in 1988-89, 250 in 1989-90 and 330 in 1990-91.

32. The <u>disadvantages</u> are that -

a. running two grant/contribution scales simultaneously is bound to be more complicated for local authorities, particularly where the same parent has one student on the old scale and one on the new scale. We do not think there can be any guarantee in advance - even if we consult DES - that local authorities will be able or willing to run such a system satisfactorily. In practice, they might be able to scupper the whole reform by putting obstacles - whether genuine or not - into the way of implementation;

b. there would be some rough edges. Second and third year students who did not have a covenant by Budget Day would remain on the old (lower) grant scale but would no longer have the opportunity to get a covenant. Conversely, a first-year student who already had a covenant before the Budget in anticipation of going to University would get the new (higher) grant in addition to covenant relief. This could cause complaints of unfairness (though it is worth noting that the second-year student without a covenant would not be any worse off than he was in his first year).

<u>Balance of advantage on Options</u>

33. We see substantial advantages in the Option 1 approach - it is clear, should work relatively easily and gives us maximum early staff savings. But the Treasury are concerned about the

transitional cost, bearing in mind the pressure for additional spending which DES are already exerting in the Review of Student Support. That cost could be substantially avoided by Option 2 or 3.

34. The main question over Option 3 is whether local authorities would be able and willing to work it. We see no way of guaranteeing that.

35. Option 2 should also work. But it is more complex, would defer the benefits of reform in this area, and would allow time in which potential losers could exert pressure for compensation. On the other hand it could permit the compensation for student support to be applied in a way which also helped deal with other cost pressures emerging from the Review of Student Support.

Consultations with Education Departments

36. All this raises again the question whether - and if so when - we should consult the education Departments (DES, the Scottish Office and possibly the Northern Ireland Office) to seek their views.

37. If the choice is Option 1 or 2, we doubt whether it is necessary to consult the education Departments more than a short time in advance - perhaps 2-4 weeks. With a single grant scale, there should be no administrative problems for local authorities. And with grants increased to compensate fully for loss of covenant relief (at least for mandatory award holders), it is difficult to see grounds on which they would object.

38. If the choice is Option 3, however, the education Departments ought to be consulted at an earlier stage. They will have views on the policy implications and would have to defend the policy behind the change in the grant arrangements - for example any apparent inequities between old and new students. DES may be also able to give some guidance on whether local authorities could cope administratively with something like

Option 3. Even so, we think they cannot guarantee in advance that local authorities will be able and willing to co-operate in practice. In any event, it is important to get them on our side if local authorities resist the changes.

39. On the timing of consultation on Option 3, DES have recently announced the grant scales for the academic year 1988-89. This is however only a preliminary announcement and the scales could be altered after the Budget. It would be awkward to consult them very soon after the announcement because they would feel they ought to have been warned earlier. But there should be no particular embarrassment from that point of view in consulting them (say) later this month.

Questions for decision

40. The questions for decision are -

a. do Ministers feel that the transitional cost of Option 1 is acceptable?

b. if not, which of the other Options do they prefer?

c. when and how should the education Departments be consulted?

C STEWART

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
7 January 1988

CORLETT TO FST 7 JAN

1. MR ISAAC

2. FINANCIAL SECRETARY

I agree with this view.

COVENANTS (STARTER 150)

1. Mr Stewart's attached paper is not on the Chevening agenda, but you may find it helpful to glance at it by way of background. It addresses one of the two difficult areas still for discussion on the reform of maintenance/covenants relief - what to do about easing the problem of future losers amongst students and their parents. (The other issue - what to do about future maintenance relief losers amongst unmarried mothers and their children - will be dealt with in a separate minute in the next day or so.)

2. When the student issue was discussed previously by Ministers, there was some natural concern that the most straightforward way of handling the student transition - that is, by giving increased grants to all qualifying students, including those who have existing covenants on which relief will continue to run - might be over-generous, and therefore unnecessarily expensive.

---

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
Mr Battishill
Mr Isaac
Mr Beighton
Mr Calder
Mr Davenport
Mr Stewart
Mr Yard
Mr Golding
Mr Boyce
Miss Dougherty
Mrs Fletcher
PS/IR
Mr Corlett

3. So we have looked at two other options. One would put off the change-over date for a couple of years, which would reduce the transitional cost. The other would seek to introduce a less expensive dual rate of grant, again for a transitional period.

4. You will see that there are real risks with both of these approaches. The first, by delaying the reform, gives the rats time to get at it - and there will be plenty of vested interests who will want either to spend the money in some other way or to retain the relief itself. The second puts the administration very much in the hands of the DES and local authorities, and, if they refuse to play ball, in a powerful position to block the reform.

5. So we in the Revenue come down strongly in favour of the original proposal - Option 1 in Mr Stewart's note. It is clean and quick. By minimising the losers, it invites the least opposition. Its introduction this year is eased by a wider tax reform and tax reductions - and this may be a unique opportunity in which to end a well-established relief. And the figures suggest that, in practice, the net transitional Exchequer cost of the covenant reform as a whole is likely to be pretty small against the Budget as a whole.

6. Nevertheless, the expenditure side of the Treasury are worried about that cost, and are keen, if possible, to wrap up the increase in grants into a more general reform of student support, such as the loans proposals. They therefore tend to favour delaying the implementation (Option 2). As I have indicated, we fear that that could mean two years of unnecessary trouble, with Treasury Ministers' backs very much up against the wall. X

I agree strongly - and particularly with X.

C W CORLETT

C.L.C.T. 7.1

975/1

CONFIDENTIAL

FROM: T J BURR

DATE: 12 January 1988

BURR TO CH. 12 JAN

1. MR ANSON

2. CHANCELLOR

Copies attached for:

Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary

cc Sir Peter Middleton
Mr Kemp
Mr Scholar
Mr Culpin
Mr Gilmore
Mr Turnbull
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Isaac-IR
Mr Corlett-IR
PS/IR

STUDENTS AND COVENANTS

Mr Corlett's submission of 7 January, which was agreed with the Treasury, considered the options for compensating for the proposed withdrawal of of tax relief on covenants in favour of students. I understand that, at Chevening, the option involving a two year deferral of the change for students (option 2) was ruled out. The choice is now therefore between reducing the parental contribution for everyone this year irrespective of whether they are already benefitting from covenants (option 1), and reducing the parental contribution for new students only (option 3) in order to minimise the extent to which those who retain tax relief on existing covenants will also benefit from a reduction in the parental contribution. This submission provides an assessment of the relative merits of options 1 and 3 from the standpoint of their implications for student support expenditure and administration.

The options

2. Under both option 1 and option 3, tax relief on new covenants would cease to be available from the Budget. Those with existing covenants would however continue to benefit from tax relief. Their numbers would diminish as the students in question moved out of higher education, as most of them would do by the summer of 1990 (although a residue would remain in higher education for up to a few years beyond that).

451

3. Both options would compensate for the withdrawal of tax relief, which is at the basic rate only, by reducing assessed parental contributions by 27%. For those at or above the top of the parental contribution scale, who pay a full parental contribution and get no grant, a minimum grant would be introduced equivalent to 27% of the full grant. Thus where grant was paid at the mandatory rates, the financial effect would replicate out of the present tax relief on covenants equivalent to the assessed parental contribution.

4. The difference between the two options is that option 1 reduces the parental contribution for all students receiving support at mandatory rates from the start of the next academic year in the autumn, irrespective of whether they retain the benefit of a covenant; whereas option 3 restricts the reduced parental contribution to those who are newly starting courses of higher education. Although there would no doubt be some people who had already arranged covenants before the Budget in respect of students starting courses in the autumn, option 3 would to a large extent eliminate parental contribution reductions for those who continue to benefit from existing covenants. The main roughness of option 3 is that, while it would give a parental contribution reduction to all new students with grants at mandatory rates, it would do nothing for existing students who, for whatever reason, did not not have a covenant prior to the Budget. But their loss would be essentially the same self imposed loss which they (or their parents) experience now, by choosing not to covenant and claim tax relief.

5. Neither option would do anything for those of the 100,000 or so students (out of an overall total of 625,000) who do not get grants at mandatory rates (and would therefore not benefit from the reduction in the parental contribution), but who would have had a covenant and benefitted from tax relief if that had continued to be available. And neither option compensates for loss of tax relief on any covenanting at levels in excess of the assessed parental contribution.

Costs

6. The net Exchequer costs of each option were set out in the Inland Revenue submission of 7 January. The tax effects are the same in either case. The differences arise on the public expenditure costs in respect of increased grant

payable as a result of the reduction in parental contributions (and new minimum grants), and are as follows:

£million

	1987-88	1988-89	1989-90	1990-91	1991-92
Option 1	-	75	115	115	115
Option 3	-	25	63	100	115
Difference	-	50	52	15	-

Thus while both options entail a substantial continuing addition to public expenditure in the longer term (though more than offset by additional revenue resulting from the withdrawal of tax relief), the cost of option 1 would be well over £100 million more over the transitional period as a whole.

Discussion

7. The public expenditure arguments therefore point clearly to option 3. Aside from the roughness mentioned in paragraph 4 above, which hardly seems a very powerful consideration, the difficulty with option 3 is a practical one. It would require Local Education Authorities, who administer student grants in England and Wales, to operate two parallel parental contribution scales: one for those who had started courses before the Budget; and one for those who started afterwards. Within a couple of months of the Budget, LEAs would have to be in a position actually to start making awards on this new basis, of which they would have had no prior warning. A number of problems can be foreseen:

(a) there might be difficulty in borderline cases in distinguishing between a new and an existing course;

(b) contributions are calculated on the basis of parental income and then apportioned between students in the same family, but the basis of calculation and apportionment would not be straightforward if one student was on a new and one on an existing course;

(c) problems of these and other kinds would probably have to be resolved with no more information than is normally collected, since in the time available it might be difficult to reprint and reissue application forms;

(d) LEAs would have to gear up to pay the minimum grant to students who at present get no grant.

8. Most obviously, LEAs would have to ensure that their staff consistently selected the right grant scale in each case, which is not a problem at present because there is only the one scale.

9. It seems to us that ~~their~~ these are problems which LEAs ought to be able to overcome without undue difficulty. Most of them will no doubt get straight on with ensuring that they will be in a position to operate the Mandatory Awards Regulations implementing the change, which is part of their duty as Local Education Authorities. But others may lose time complaining about the additional burden as they see it, and may as a result fail to get their act together in time, with consequent confusion in the handling of applications. LEAs unsympathetic to the Government might even calculate that any confusion would be a setback for the Government rather than for them, and not exert themselves to avoid it. (ILEA, for example, is at odds with the Government over both rate capping and opting out, and has some 40,000 students.)

10. Option 1 avoids these difficulties, but only at substantial public expenditure cost. It would in principle be possible to consider ways of reducing that cost, for example by not introducing a minimum grant but letting the revised parental contribution scale taper out to zero as now. A useful estimate of the saving that would result could only be obtained from DES; but it could be significant, since they tell us that about one-third of mandatory award holders at present get no grant because their parental income is too high. In the absence of a minimum grant, of course, parents on high incomes would get no compensation for the loss of tax relief on covenants (which, however, is only at the basic rate).

Next steps

11. Unless you wish now to rule out one or other of the options, we think that DES should be consulted before a decision is taken. They have a clear interest whichever option is chosen. On the one hand the DES Accounting Officer, Sir David Hancock, might be criticised by the PAC for the waste inherent in option 1, which compensates a lot of people for losses which they have not experienced. On the other, DES would have to issue guidance to LEAs on the operation of two parental contribution scales under option 3; and while DES

have little direct experience of administering student grants, their closer familiarity with the system means that they may well be able to draw attention to points which we may have missed. They clearly need to be fully committed to whichever option is selected.

12. There would also be advantage in consulting the Scottish Education Department. The grant system is somewhat different in Scotland, and is administered directly by the SED. It would be difficult not to warn them before the Budget in any case. To consult them now would enable them to give definitive advice on feasibility in Scotland, which might also help to illuminate the practicalities in England. The system in Northern Ireland is not very different from that in England and Wales, and probably nothing would be gained by consulting them at this stage.

13. It is of course of key importance that there is no leak, since that would lead to massive anticipation of the change by taking out covenants before the Budget. We therefore recommend that the right course would be for Sir Peter Middleton to approach the official heads of DES and SED (Sir David Hancock and Mr Russell Hillhouse respectively). There is a question whether we should seek to specify which other officials in their Departments they can involve, but it seems best to leave that to their judgement on the basis that knowledge should be limited to the maximum extent possible and that the Head of the Department is personally responsible for preventing any leak. As former Treasury officials, both will be familiar with the stringent demands of Budget security.

14. You would no doubt also want to mention the matter to Mr Baker and Mr Rifkind; but it might be better to take opportunity to do that orally than to send a letter which might be seen by others in the Department concerned.

Recommendation

15. We therefore recommend that, before a decision is taken between options 1 and 3, DES and SED should be consulted, on the very restricted basis proposed; and we would be grateful for your authority to do that. You will wish to discuss at your meeting on 15 January.

T J Burr

T J BURR

PARENTAL CONTRIBUTION SCALE

Undergraduate "elsewhere" rate of grant (£2050)

£

Residual income+	(a) 1988-89 contribution		(b) (a) reduced by 27 per cent	
	1 child	2 child	1 child	2 child
9900	50		35	
10000	64		45	
11000	207		150	
12000	350		255	
12600	435		320	
12700	455		330	
12800	475		345	
12900	495		360	
13000	515		375	
14000	715		520	
15000	915		670	
16000	1115		815	
17000	1315		960	
18000	1515		1105	
18400	1595		1165	
18500	1620		1185	
19000	1745		1275	
20000	1995		1455	
20220	2050 max		1495*	
21000		2245	1640	
22000		2495	1820	
23000		2745	2005	
23250		2805	2050 max	
24000		2995		2185
25000		3245		2370
26000		3495		2550
27000		3745		2735
28000		3995		2915
28420		4100 max		2990*
29000				3100
30000				3280
31000				3765
31620				3575
32000				3645
33000				3830
34000				4010
34490				4100 max

+ Residual income is gross income less certain allowances such as mortgage interest payments and dependent pension schemes which qualify for tax relief, life assurance premiums, superannuation payments and domestic assistance.

* Maximum contribution if there is a minimum grant of 27 per cent of the full grant.

STUDENTS & COVENANTS

ANSON TO CH. 13 JAN

SC

CONFIDENTIAL

FROM: J. ANSON
13th January, 1988.

CHANCELLOR

c.c. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr. Kemp
Mr. Scholar
Mr. Culpin
Mr. Gilmore
Mr. Turnbull
Miss Sinclair
Mr. Burr
Mr. Cropper
Mr. Tyrie

Mr. Isaac, IR
Mr. Corlett, IR
PS/IR

STUDENTS AND COVENANTS

The attached note by Mr. Burr considers the options for compensating students, on the basis that the benefit of student covenants will no longer be available for covenants signed on or after Budget day. The basic choice is between Options 1 and 3 of the Revenue submission of 7th January.

2. In order to clarify the effect of adjusting the scales, I have attached to Mr. Burr's note (a) the scale for the academic year 1988-89 and (b) how that scale would look if the parental contributions were reduced by 27%. Under Option 1, the second of these would be used for all students from next September. Under Option 3, the second scale would be used for new students, and the first for continuing students.

3. Mr. Burr's paragraph 4 brings out the point which I made at Chevening that Option 3 largely avoids compensating

students who continue to benefit from existing convenants. Option 1 spends an additional £117 million over three years to compensate those who have not suffered, or those who (by not having a covenant) have chosen to suffer.

4. In a straight rearrangement of the tax system a certain amount of roughness in leaving fortuitous gainers and losers can be tolerated. But Option 1 would be a deliberate use of voted money on a cost-ineffective way of achieving the required objective, when a more effective method, without the same deadweight cost, has been identified. And while one can never rule out the local authorities making difficulties over anything, I feel that objectively they would not have grounds for doing so in this instance. The distinction between new courses and continuing ones is fairly obvious, and except in the relatively rare case of two students in a family, it would simply be a question of reading off one published scale rather than another.

5. Mr. Burr suggests that we should consult DES, and I would support that. But I hope we could put Option 3 to them as our proposed course, and leave them to argue, if they are minded to do so, about the difficulties with the local authorities. I would not want to create a situation where DES could afterwards justify using the more expensive Option by saying that the Treasury presssured them into doing it.

6. There is also one subsidiary point, in paragraph 10 of Mr. Burr's minute, about whether the "new" scale should have a minimum grant of equal to 27% of the standard maintenance grant, or should be tapered down from that to zero at progressively higher levels of income. The second of these would, of course, give less than complete compensation at income levels above where the present taper ends. It would thus create a (probably rather articulate) group who would complain about the reform being unfair.

CONFIDENTIAL

But it would be rather cheaper, and it would avoid re-creating the concept of a "minimum grant". Perhaps we could discuss at your meeting on Friday whether this sub-option should also be discussed with DES.

J. ANSON

ANNOTATED AGENDA.

4480/42

CONFIDENTIAL

FROM: MISS C E C SINCLAIR
DATE: 14 January 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilmore *
Miss Peirson *
Mr Burr *
Mr McIntyre *
Mr Riley
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Corlett - IR
Mr C Stewart
Mr Mace

MAINTENANCE AND COVENANTS: MEETING ON 15 JANUARY - ANNOTATED AGENDA

1. The relevant papers for this meeting are:

Miss Sinclair's minute of 23 December:	Replacing the Additional Personal Allowance (APA) and Tax Relief on Certain Maintenance Payments by Increased Benefits
Mr Isaac's minute of 8 January:	Maintenance Payments & One-Parent Benefit
Mr Stewart's minute of 8 January:	Maintenance - unmarried mothers
Mr Corlett's minute of 7 January:	Covenants

* Relevant section of agenda only.

CONFIDENTIAL

Mr Stewart's minute of 7 January:	Covenants
Mr Burr's minute of 12 January:	Students and Covenants
Mr Anson's minute of 13 January:	Students and Covenants
Miss Sinclair's minute of 13 January:	Replacing the Additional Personal Allowance (APA) and Tax Relief on Certain Maintenance Payments by Increased Benefit

2. I attach an annoted agenda for the meeting.

CAROLYN SINCLAIR

MAINTENANCE/APA

(i) Is it necessary to compensate unmarried mothers for the loss of tax relief on maintenance payments?

(ii) Are any of the tax solutions to this problem (Options 3, 4 and 5 in Mr Stewart's paper) acceptable?

(iii) Can enhancement of OPB be justified purely to compensate this group of future losers?

(iv) Can it be justified purely to permit abolition of APA?

(v) Can it be justified to achieve the tax policy objectives of abolishing both APA and tax relief for children? Would the consequences for the Treasury stance on benefits generally be acceptable?

(vi) Or would it be better to abolish APA without compensation (Option 1 in the interdepartmental report)?

(vii) Or to retain APA but limit it in scope either by linking it to OPB eligibility (Option 3) or as in Option 2?

(viii) Should you have an early meeting with Mr Moore, not preceded by further contact between officials?

COVENANTS

It has been agreed that tax relief on new covenants between individuals should cease with effect from 1988. The issue here is how future students/parents should be compensated.

(i) Option 3 compensates only new students, and costs over £100 million less than Option 1 over the transitional period as a whole, given a basic rate of 27 per cent (NB if the basic rate were to change, all costing would be affected). But it requires two parental contribution scales. Should we accept the resulting risk of hassle with local education authorities, who could foster confusion to embarrass the Government; as well as complaints from existing students without covenants who would stay on the lower grant?

(ii) Option 1 would over-compensate sizeable numbers of people. Could that be justified, and would it whet the DES appetite for more spending on student support?

(iii) In the light of (i) and (ii), do you prefer Option 1 or Option 3?

(iv) Do you want to reintroduce a minimum grant? Or would you allow the revised parental contribution scale to taper out to zero as now (paragraph 10 of Mr Burr's minute)? This would mean that parents on high incomes would get no compensation for the loss of basic rate tax relief on covenants.

(v) Do you agree that if Option 3 seems worth pursuing, Sir Peter Middleton should write now to the offical heads of DES and SED seeking their views? Should this letter also raise the issue of recreating the minimum grant, or simply put forward your decision on this?

(vi) Do you agree that you should simultaneously speak (not write) to Mr Baker and Mr Rifkind? What arrangements should be made for that?

(vii) If Messrs Baker and Rifkind oppose Option 3, would you want to adopt Option 1?

3978/1

CONFIDENTIAL

FROM: P J CROPPER
DATE: 14 January 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Gilmore
Mr Anson
Miss Peirson
Miss Sinclair
Mr Burr
Mr MacIntyre
Mr Tyrie
Mr Battishill IR
Mr Isaac IR
Mr Corlett IR
Mr Mace IR
Mr C Stewart IR

CROPPER TO CH. 14JAN

STUDENTS AND COVENANTS

In deciding what to do about student covenants, I think we must look forward to the question of presentation and ask ourselves whether we are going to be able to avoid having to indicate what grander design this is part of. This will be all the more important if we decide to go, or are driven, along the line hinted at by Mr Anson - i.e. that some people, probably those on high incomes, will not be fully compensated for loss of covenant benefit, thus allowing that part of the over-all saving to be used for needier cases.

2. There are those, and I am one of them, who believe that parents should not have to support their adult children at all during further education. Hence the attraction of a student loan scheme. People like me will be stirred up angrily if the ending of covenants is accompanied by an uncompensated addition to the parental contribution. These are the people who rioted in the streets when the minimum grant was abolished. You will hardly want them out again. But I think you would

probably have them <u>supporting</u> you if they were told that they were only being temporarily sur-charged, pending the emergence of the loan scheme.

3. I know that, in this argument, I and my like are branded as rich middle class people who are squealing without being hurt. I think it is the principle of the parental contribution itself that hurts. If I may just rehearse.

4. Education has three distinct phases. Up to the age of 16 it is compulsory and universal. There is a case, therefore, for making it "free" at point of consumption. Everybody will enjoy the same amount of education in the course of a lifetime, so there are no "redistribution" implications. <u>But</u>, if education is free, there has to be limited choice: there is no scope for market forces, and there is no practical way of avoiding enforced selection.

5. So vouchers are the answer for the under 16s: vouchers, to my mind, with the option to top up.

6. When we come to higher education, 18 and over, we are dealing with adults. It is in the nation's interest that any talents that are capable of being developed by higher education should be so developed. It is also undeniable that a higher education purchases, in most cases, a higher lifetime income level. It is quite reasonable that the recipient of that advantage should pay for it. It is quite unreasonable, to my mind, that the parent should have to pay for it. After all, the parent has laid out a deuce of a lot of money bringing the child up to adulthood already.

7. The middle group, 16-18, represent a difficult but soluble marginal problem.

8. A student loan system seems to me to be the obvious solution. But in the absence of a loan system I would rather see the State paying for <u>all</u> higher education than see parents having to pay for some of it - even if the poorer parents are relieved on a means tested basis.

9. To recapitulate, if there are others who feel as I do, and I believe there are, then we would be asking for trouble to take the route hinted at by Mr Anson. Furthermore we would be asking for trouble if, even inadvertently, we gave any indication that the newly re-introduced minimum grant were in any way a temporary feature. For all these reasons I should like to see the abolition of covenants accompanied by an indication that we are moving firmly in the direction of a loan scheme.

PJC

P J CROPPER

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 14 January 1988

FST TO CH 14 JAN

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Mr Kemp
Mr Scholar
Mr Culpin
Mr Gilmore
Mr Turnbull
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
Mr Isaac IR
Mr Corlett IR
PS/IR

STUDENTS AND COVENANTS

I have seen the papers on this and have considered them ahead of your meeting tomorrow.

2. I favour Option 3 which aims to minimise the extent to which those retaining tax relief on existing covenants will also benefit from the 27% reduction in the parental contribution. It does this by confining the reduction in the parental contribution to new students only.

3. There would be rough edges to this option. In particular existing students who did not have a covenant prior to the Budget would not get the benefit of the reduced parental scale. However, students in this position would not be any worse off in their second year than in their first year - they (or their parents) would simply not be as well off as they would have been either under Option 1 or if they had had a covenant.

4. The main argument against Option 3 is administrative. Will a two-tier system be workable? I think we will need to put Option 3 to DES in order to answer that question. But, at first blush, the administrative complexities do not look too daunting. Given the public spending saving available if we choose Option 3 rather than Option 1. I am sure that it is worth getting DES to sign up to Option 3 before we suggest the more generous option to them.

5. On the reintroduction on the "minimum grant", I am rather agnostic but it does seem to me that there are presentational arguments in favour of continuing with no minimum grant:

(i) because it has only fairly recently been abolished;

(ii) because together with other measures in the Budget reintroduction of a minimum grant would appear to be another "regressive" measure.

NL

NORMAN LAMONT

pmp

CONFIDENTIAL

FROM: S P JUDGE
DATE: 14 January 1988

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Scholar
Mr Culpin
Mr Gilmore
Mr Turnbull
Miss Peirson
Mr MacIntyre
Miss Sinclair
Mr Burr
Mr Cropper
Mr Tyrie
PS/Inland Revenue
Mr Isaac - IR
Mr Corlett - IR
Mr C Stewart - IR
Mr Mace - IR

JUDGE TO PS/CX 14 JAN

STUDENTS AND COVENANTS

The Paymaster General has seen Mr Anson's submission of 13 January, and the notes of today from the Financial Secretary and Mr Cropper. He is unfortunately unable to attend the Chancellor's meeting tomorrow afternoon.

2. By way of historical background, he thinks it is useful to recall the original plan in the last Parliament:

- halving the minimum grant in **1983**;
- reducing it to zero in **1984**; and
- making people contribute towards tuition fees, up to a maximum of £500, in **1985**.

Due to his 1984 concerns with the science budget, Sir Keith Joseph tried to elide the second and third stages. This was what caused trouble. The riot in Mr Cropper's street was not caused by the proposal to reduce the minimum grant to zero, but by the tuition fee proposal.

3. The Paymaster raises this in part because he is reluctant to see a minimum grant return, and in part to emphasise that the problem in 1984 was centred on families with residual incomes of £15-20,000 - corresponding to gross incomes about £2,000 higher.

4. The Paymaster has shifted to being in favour of option 3, but is ambivalent on tapering. He is uneasy because the problem is concentrated exactly where it was in 1984, but likes it because it prevents the minimum grant returning. The overall plan also has the beneficial effect of pushing higher the residual income at which the maximum parental contribution is due. (At present this maximum is £4,900 - 2.4 x the "elsewhere" rate - payable at a residual income of £31,620. With the new scale a parental contribution of £4,900 corresponds to residual income of £38,870.)

5. The Paymaster realises he has changed his mind on the practicality of having two contribution scales running simultaneously. If the question on the form is very clear, then Local Authorities should be able to cope. They will no doubt complain and could behave in a frustrating way. This makes it essential to consult DES. But the Government would have a good story to tell.

S P JUDGE
Private Secretary

discuss the prospects of a power cable link-up between Iceland and the national grid, for the import of power generated in Iceland to the United Kingdom.

Mr. Michael Spicer: The supply of electricity in bulk is the responsibility of the electricity generating boards. I understand that representatives of the Icelandic Power Company have had informal discussions with the Central Electricity Generating Board. The board is keeping the possibility of a cable link under review.

Electricity Supply Industry (Revenue Collection)

Mr. David Nicholson: To ask the Secretary of State for Energy whether he has received the third response by the electricity supply industry to the report by the Monopolies and Mergers Commission on the revenue collection systems of four area boards; and if he will make a statement.

Mr. Michael Spicer: I have now received from the Electricity Council, on behalf of all area boards, its third response to the report of the MMC published in January 1985 on the revenue collection systems of the East Midlands, South Eastern, North Eastern and South Western area electricity boards (Cmnd. 9427). I am placing copies of the response in the Library of the House.

This final response notes the progress made and the conclusions reached in reviewing the MMC's recommendations since my hon. Friend the Member for Eddisbury (Mr. Goodlad) announced receipt of the second response on 29 July 1986, at columns 361-62. In particular,

—each area board has now set itself targets for reducing meter reading, billing and collection costs. Progress in achieving the targets is monitored regularly as is performance between boards;

—a detailed study indentifying 'best practices' in revenue collection procedures has been completed and all boards are responding positively to its conclusions;

—detailed methods of allocating revenue collection costs based on national accounting guidelines are operated for the purposes of both management cost control and inter-board comparisons. All boards have reviewed their allocation practices to ensure that they comply with these guidelines.

The industry is continuing to keep revenue collection practices under review and the response concludes by noting that privatisation may bring about further changes in these.

The MMC's report and the response of the industry to its recommendations have been a valuable contribution to improving efficiency.

EDUCATION AND SCIENCE

Student Grants

Mr. Andrew F. Bennett: To ask the Secretary of State for Education and Science when he will announce the level of student grants for the year 1988-89.

Mr. Jackson: Subject to Parliament's approval of the necessary regulations, the main rates of student grant will be increased by 4 per cent. in the 1988-89 academic year. In England and Wales the new rates will be as follows (rates for 1987-88 are show in brackets):

	Undergraduate (£)	*Postgraduate (£)*
Hall or lodgings		
(i) London	2,425 (2,330)	3,630 (3,492)
(ii) Elsewhere	2,050 (1,972)	2,975 (2,859)
Parental home	1,630 (1,567)	2,160 (2,070)

The threshold for parental contributions, and the points on the contribution scale at which the rate of contribution changes, will be uprated on average by about 6·5 per cent. Parents whose residual income is below £9,900 will not be assessed for a contribution. The minimum contribution will be increased from £40 to £50 and the maximum, which in general applies only to parents with more than one child in receipt of grant, will rise from £4,600 to £4,900.

The full parental contribution scale for 1988-89 will be as follows:

Residual income £	*Contribution* £
9,900	50
10,000	64
11,000	207
12,000	350
12,600	435
12,700	455
12,800	475
12,900	495
13,000	515
14,000	715
15,000	915
16,000	1,115
17,000	1,315
18,000	1,515
18,400	1,595
18,500	1,620
19,000	1,745
20,000	1,995
21,000	2,245
22,000	2,495
23,000	2,745
24,000	2,995
25,000	3,245
26,000	3,495
27,000	3,745
28,000	3,995
29,000	4,245
30,000	4,495
31,000	4,745
31,620	[1]4,900

[1] Maximum.

Notes:

1. For 1988-89 the level of contribution will be assessed at £1 in £7 for residual incomes from £9,900 to £12,600; then £1 in £5 to £18,400; and £1 in £4 thereafter. (In 1987-88 it is assessed at £1 in £7 for residual incomes from £9,300 to £11,800; then £1 in £5 to £17,300; and £1 in £4 thereafter.

2. The contribution payable may be less than the amounts shown on the scale, particularly at its top end and where the contribution is in respect of one award-holder only. This will depend on the amount of grant against which the contribution has to be set and whether any of the assessed contribution is offset by alowances for other dependent children.

Primary Schools

Mr. Cohen: To ask the Secretary of State for Education and Science when he expects to respond to the Third Report on the Select Committee on Education, Science and Arts on achievement in primary schools, Session 1985-86, H.C. 40-I.

975/2

CONFIDENTIAL

FROM: T J BURR

DATE: 14 January 1988

1. MR ~~GILMORE~~ Approved in draft. TJB

2. CHANCELLOR

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Spackman
Mr Turnbull
Mrs Butler
Mr McIntyre
Miss Noble
Mr Parsonage
Mr Richardson
Mr Bolt
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac-IR
Mr Corlett-IR

Ch/ Content to write as proposed? (But you may like to wait until after tomorrow's meeting) AT 14/1

BURR TO CX 14 JAN

REVIEW OF STUDENT SUPPORT

This submission reports the latest developments in the review of student support, and brings to your attention a paper which DES have now prepared as a basis for discussion between you and Mr Baker. This is essentially a quantified version of the radical proposals earlier put forward by the DES higher education Minister, Mr Robert Jackson. The submission proposes, however, that prior to any meeting with Mr Baker you should write to him emphasising the urgency of making progress towards a more limited but practicable scheme. Some of Mr Jackson's ideas may be well worth considering for the longer term, once loans are in place. But to attempt to get there in one step as he proposes is in practice likely to ensure that no loan scheme at all is introduced in the foreseeable future.

2. The submission may also provide helpful background to your meeting at 3.45 pm tomorrow. In due course a meeting with Mr Baker is likely to be necessary, and we would provide further briefing for that.

Background

3. At your meeting with us on 11 November you discussed progress on the review of student support. Discussion was based on my submission of 5 November to the Paymaster General, to which I attached a paper which Mr Jackson, the DES Minister for higher education, had prepared. The paper proposed that privately financed loans should replace existing student grants, and that the money devoted to the latter should be redeployed in a number of new selective forms of support such as bursaries, scholarships, and support for students from disadvantaged backgrounds. But since Mr Jackson's objective was clearly that loans should be available to all students, and he wished to guarantee them to a level which would ensure that they were (although his own assumptions about the necessary guarantee were optimistic), it seemed highly questionable whether a switch from grants to loans of that kind could be regarded as a saving in public expenditure in other than a nominal sense. On that view, there would be no headroom for the proposed new forms of selective support, and the scheme would not be viable.

!

4. You saw attractions in some of the proposals, but felt that the overall package was unacceptable. You thought, moreover, that any scheme involving financial institutions as principals rather than agents would probably take too long to negotiate with them, and that it was better to concentrate on a relatively simple and straightforward scheme for replacing social security benefits to students and a substantial element of grant with loans, on the lines originally envisaged before Mr Jackson took over the chairmanship of the review. Such a scheme was presented in Mr Gilmore's submission of 16 November to the Paymaster General, and subsequently shown to Mr Jackson at a meeting between him and the Paymaster General on 18 November. Both at that meeting and at a subsequent meeting which Mr Jackson arranged with Mr Gilmore and myself, we argued the points which you had made. But Mr Jackson persisted in his view that the scheme which we had put forward was a "mouse" (as he put it), and that a much more radical approach on the lines of his paper was required.

This is attached behind.

5. The latest development is that Mr Jackson's proposals have been developed further and worked up into a paper by DES officials, which has been approved by Mr Jackson and, we understand, shown to Mr Baker. DES sent us the paper at the end of last month, as a basis for a discussion between you and Mr Baker. A copy is attached.

6. Mr Jackson has also stressed to us that these proposals are to be seen in the context of wider ideas for the reform of higher education which he has outlined informally to us. These centre round the concept of higher education institutions as independent contractors selling their services to the Government (for basic research) and to students (for teaching). The latter would receive financial support to enable them to buy these services, which would obviously become a key aspect of the wider system of student support.

The paper

7. The paper proposes that both social security benefits for students and the present grants related to student needs and subject to a parental contribution should be abolished. In their place there would be a new grant at a lower level than the present one, which would be means tested on parental income but would not formally be subject to an assessed parental contribution as now. This is perhaps a fine distinction; but Mr Jackson has made it, and there may be some advantage inholding onto it, since it could help to preserve the substance of selectivity in the grant system while dropping the presentationally unattractive 'assessment' of contributions. The point is that there would be no presumption that parents should make good that element of the grant which was withheld on grounds of parental means. There would also be bursaries on a selective basis to meet specific policy objectives, such as to encourage study of shortage subjects or to reward high attainment. There would also, of course, be loans.

8. Two broad approaches to the provision of loans are suggested in the paper. First, loans could be publicly financed. Alternatively, they could be financed by financial institutions, and the following alternative devices are suggested for ensuring that loans would in practice be made available to all students:

(a) **Bank licences.** The Government would invite financial institutions to compete for a licence to provide privately-financed student loans;

(b) **Pooled insurance.** Participating financial institutions would have a pooled insurance arrangement for the risk of default on student loans, and the Government would contribute to the cost of that insurance;

(c) **Government guarantees.** The Government would guarantee a proportion of each student loan against default.

Financial implications

9. A main difference between this paper and its predecessor is that the proposals are quantified and costed. With publicly financed loans, the scheme is stated to have an additional public expenditure cost of £340 million at the outset (no doubt diminishing as loan repayments began to flow in, but with no quantification of the longer term effects). That cost arises essentially from the replacement of the present parental contribution, which is not public expenditure, by loans which are.

10. The paper nevertheless recognises that an addition to public expenditure of £340 million might be regarded as excessive, and suggests that in that case the privately financed options should be considered. In assessing the financial implications of these options, the loans themselves are consistently ignored. All that is taken into account is the reduction in existing grant and social security expenditure, interest rate subsidies, and default costs (for Government guaranteed schemes).

11. Even on that basis some of the costings (which confusingly do not correspond precisely to the options presented in the paper) show a net cost in the longer term. But in considering the financial implications, it is also not possible to ignore flows of bank finance to students which, while they do not formally count as public expenditure, are nevertheless drawn by Government intervention from the rest of the economy. On that basis none of the variants on a privately financed loan scheme would show any financial advantage as compared with a publicly financed scheme. (Indeed they look worse because of the explicit interest rate subsidy; but it would of course be necessary to allow in the comparison for the implicit interest rate subsidy in a publicly financed scheme.)

12. The DES paper does not really attempt to grapple seriously with the above arguments. It simply asserts that, because the Government does not regard lending under fixed rate export credit schemes as public expenditure, there is no need to regard privately financed and Government guaranteed loans to students in that way either. This, of course, misses the point. It is not a question of what may or may not be defined as public expenditure. (While some of the devices proposed in the paper could raise classification issues - notably an exclusive licence to lend to students - we would not generally seek to argue that privately financed loans are public expenditure.)

The point is whether it is sensible to ignore for the purposes of policy on student support lending which happens to be financed by bank borrowing rather than Government borrowing. Obviously that is not sensible: there can scarcely be a public expenditure programme where a plausible scheme could not be devised for moving expenditure "off budget" by replacing it with Government subsidised and/or guaranteed private finance (and if we had to choose between those programmes we would hardly give priority to increasing support for students, which is already generous by international standards). There may be good reasons for looking in due course to bank financing, but these need to be based on efficiency and flexibility, not on arguments about classification.

cc Daniel Theory / Review

13. Some attempt is also made in the paper to argue that because parents are "deemed in law" to pay the parental contribution, it is analogous to public expenditure (on the students) financed by a tax (on the parents). A parallel argument would be to say that there may not be much to choose between the effects on aggregate demand of loans (whether publicly or privately financed) and of parental contributions, to the extent that the latter are financed from savings; and that it ought therefore to be possible to contemplate a switch from one to the other, especially as loans also have beneficial incentive effects. But, first, it is far from clear that parental contributions are even mainly financed from savings. Second, there is in any case another important difference. While there is an implication that parents should pay their contributions, there is in fact no legally enforceable obligation to do so. Whether parents pay, or pay in full, is ultimately up to them, and it is a frequent complaint that many do not. The proposed loans, however, would be available to students as of right. That is indeed one of the main attractions seen by DES: they would be able to say that they had replaced unreliable parental contributions with dependable loans. The implication is that loans on this basis would entail a materially greater degree of Government intervention to ensure that finance was available to students than does the parental contribution. On this basis the proper trade-off is between loans and existing student support expenditure, not between loans and the parental contribution.

Next steps

14. We have been discussing proposals of this kind with Mr Jackson for most of the last three months. It would of course be possible for us to continue these discussions. Now that the proposals have been costed, however tendentiously, we could go into the costings in detail with DES officials and produce a paper which represented an agreed analysis of the proposals, while

reserving your position on the substance. That, indeed, is exactly what Mr Jackson and his officials want us to do.

15. The problem with that is that we continue to see basic difficulties about the strategy proposed, in more than one respect. First, whatever the specific merits of some of Mr Jackson's ideas, it seems clear that he is trying to do too much at once. It may well be desirable in the longer term to have more selectivity in the grant element of support, to move away from the concept of an "assessed" parental contribution, and to have student loans provided by financial institutions rather than by Government. But to try to achieve all that now, at the same time as getting the principle of loans accepted as a major vehicle of student support, carries a substantial risk that we will in practice make no tangible progress in the time available.

16. This is not just a question of timing, although to be sure of introducing student loans in this Parliament legislation will be needed in the next session, which means publication of specific policy proposals by the early summer at the latest. If we move straight to privately financed loans now, when attitudes are unaccustomed to the idea that students should to some extent fend for themselves and not necessarily have all their needs met within a Government promoted scheme, it would be difficult to avoid giving guarantees and subsidies which ensure that every student can get broadly the same amount of loan on broadly the same terms. But if we proceed a step at a time, and concentrate first on getting the principle of loans accepted, attitudes may well change and it may ultimately be possible to advance towards more genuinely private sector arrangements, with less Government intervention than would be necessary if reform were attempted in one go. There may be analogies here with the Government's step by step approach to reforms in other areas, like trade union reform and privatisation.

17. The other front on which fundamental difficulties can be expected is the question of financial implications. We could spend a long time having with DES the arguments about public and private finance which we have been through in other contexts. Ultimately these arguments would lead nowhere, but they would absorb a great deal of time, which is just not available if student loans are going to be introduced in this Parliament (and they were, of course, mentioned in the Manifesto).

Recommendation

18. We therefore recommend that you should now take the initiative by writing to Mr Baker to stress the urgency of making progress. You might acknowledge that much of Mr Jackson's thinking is well worth keeping in mind for the longer term. The Treasury paper which was put forward in November (Mr Jackson's "mouse") was not intended to be more than a first step in a continuing process of reform in this area. But it does have the merit that it could with little doubt be implemented quickly. On the question of financial implications, you would avoid detailed argument about the approach to the costings which is adopted in the paper. Instead you would assert the basic proposition that student support in this country is already relatively generous, and that it was never an objective of the review to make it more so, and certainly not on the scale contemplated by Mr Jackson. At the same time you could again acknowledge that there might well be a case for some modest short-term increase in cost in order to secure the prospect of substantial savings on student support in the longer term.

19. I attach a draft in this sense.

T J Burr

T J BURR

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DRAFT LETTER

FROM: CHANCELLOR OF THE EXCHEQUER

TO : SECRETARY OF STATE FOR EDUCATION AND SCIENCE

REVIEW OF STUDENT SUPPORT

I have been following the discussions which Robert Jackson has been having with Peter Brooke and with Treasury officials about the way forward on the Review of Student Support, and the best way of moving towards our declared objective of student loans. These discussions have continued through the latter part of last year. I am now concerned that we should make early progress in deciding what proposals to put forward.

2. The urgency is clear. To fail to introduce student loans in this Parliament, after having included the idea in our Manifesto, would represent a real setback, and not only in political terms. I need not rehearse here the many arguments for student loans, but they clearly have a great deal to do with extending into higher education the major improvement in the supply side performance of the economy which has been one of our main achievements. And yet if we do not secure the necessary legislation in the next session of Parliament, the prospects for actually introducing student loans before the next Election will be poor. That means that we must have fully worked up and agreed policy proposals, ready for publication, by May or June at the latest.

3. I would like to be more confident that the radical approaches

for which Robert Jackson has been arguing provide us with a firm basis for moving forward in this timescale. But I have to say frankly that I am very doubtful about that. As now presented in the paper which, with Robert's approval, your officials have shown to mine as a possible basis for discussion between us, the proposals raise a number of difficulties with considerable potential for absorbing time that would be better spent (and indeed now needs to be spent) on pressing ahead with the central aim of simply getting a loans scheme into place as a basis for continuing reform. There may well be ideas here which we can pursue in the longer term, such as loans provided largely by financial institutions, and the abandonment of an "assessed" parental contribution (though without necessarily retreating from means testing of the grant element of support). But we need to be careful not to take on more than we can handle or resolve in the limited time available.

4. Some of these ideas will inevitably have the effect of putting us partly in the hands of others, notably the financial institutions. We would not be able to commit ourselves firmly to policy proposals in which they had a major role without first reaching agreement with them on what that role should be. But the necessary negotiations would be bound to take months at least.

5. Then there is the difficult question of the financial implications. Your Department's paper starts by contemplating a public sector scheme with an additional cost in the early years at least of £340 million a year, compared with an existing level of expenditure on mandatory student awards which the paper

puts at £480 million. This is not just clearly out of the question on financial grounds. It would also be a thoroughly bad thing on merits. We already spend more on student support than other countries, and if anything the need is to emulate them by shifting the balance of higher education spending away from grants for student consumption towards investment in their education and training. We certainly do not want to commit ourselves to more expenditure on student support, as you recognised in originally proposing the cost constraint on the Review. I do not exclude some modest initial increase in cost which can be clearly justified in terms of a firm prospect of future savings from student loans. But we will make no progress on the basis of proposals with additional costs of this sort. Even if it were possible to make sums of this order available to the education programme, I do not for a moment suppose that you would want to use them in this way. In short, we cannot approach this Review on the basis that one of the aims is to increase spending on student support.

6. The paper then says that if an addition of £340 million a year presents difficulty, private finance should be exploited instead. There is no worse reason for using private finance than simply in order to avoid facing difficult questions of resource allocation. Private institutional funding of a loan scheme might achieve some overall gains from better management and from competition between lenders, and this should at some stage be examined. But the cost to the rest of the economy of whatever scheme for student support we propose has to be faced: it is not avoided by channelling funds directly from the private sector. If it was simply a question of leaving

students to raise what funds they could from financial institutions on commercial terms, we could no doubt leave that to find its own level. But you also make it clear that you intend any privately financed student loan scheme to be largely determined by government, with institutions being obliged to lend government-guaranteed or subsidised money, in amounts largely prescribed by the government, to students designated by Government. The example of export credit guarantees, which are provided by an insurance-based organisation which charges a full commercial premium for its support, provides no case for using private finance as a device to avoid constraints on public expenditure.

7. Some months ago the Treasury circulated a paper to the Review which explored the case on merits for the use of Government-guaranteed bank finance in this area. It recognised that avoidance of public spending constraints could form no part of that case and, indeed, that the resource allocation implications of such a scheme would need to be considered in the same broad framework as for a publicly financed scheme. So it is not that our minds are by any means closed on the question of involving financial institutions. My own feeling is, however, that if we try to start by involving the banks we will greatly complicate the task of getting an acceptable scheme implemented within a reasonable period of time.

8. My own view, therefore, is that as a first stage we should concentrate our efforts on working up a simple scheme for the conversion to loan, at a zero real interest rate (itself a major concession) of social security benefits for students and a

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substantial element of the existing grant. The essence of what I have in mind has already been put to Robert Jackson by Peter Brooke, and your Department has a copy of the paper which we prepared. I would repeat that I think this needs to be seen not as a definitive medium or long-term scheme, but as a way of getting into a practical process of reform. I would hope that we could now take that as a basis and move on quickly to address the issues which arise. While much less daunting than those raised in Robert's paper, some of these issues are still difficult enough and will require a good deal of work. They include the question of compensating for highly variable social security entitlements, and the question what whether any short-term costs might be accepted as the price of longer-term savings. So there is plenty to be getting on with. Larger questions like the role of financial institutions, rolling back the parental contribution, and selective support through bursaries will need to be left to a later stage, once we have got loans into place.

9. I hope that we can have an early discussion about all this.

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6

STUDENT SUPPORT: LOANS, GRANTS AND BURSARIES

THE OBJECTIVE

1. The objective is to establish a "social market" system for student support. This would ensure that loan finance up to a fixed maximum sum (and at a level of the student's choice within that maximum) is available to all eligible students with a place. It would reduce the need to borrow by providing targeted subsidies for certain students, including grants towards maintenance assessed against parental means; and bursaries to promote "access", to reward performance, and (perhaps) to encourage certain courses of study.

2. In particular the objectives are (i) to disentitle (certain) students from housing supplementary and unemployment benefits; (ii) to reduce substantially direct expenditure on grants; (iii) to abolish the deemed parental contribution; (iv) to ensure, for the first time, that finance is available to all eligible students with a place; (v) to provide support, for the first time, to certain students on "access" courses; (vi) to shift from a student culture of dependency to one of self-reliance and economic awareness.

[A] GRANTS

3. There is a case for treating all students in higher education as independent of their family. But most systems of student support around the world do not do so, because it is believed that such a policy might differentially deter young people from poorer families from entering higher education.

4. This argument points us towards continuing to award mandatory grants assessed against parental means. But the level of such mandatory grants need not be as high as at

ROBERT JACKSON'S PAPER

present: the fact that such grants in other countries are at a lower level than those in Britain with similar or higher levels of "access" suggests that their value could be reduced without significant damage. Indeed, "access" would be more effectively promoted by closer "targeting" (see below) and by the better marketing of higher education to young people from poor families.

5. Shorn of the principle that the grant should cover the whole cost of maintenance, the decisions about the level of the maximum grant and the point of zero eligibility are essentially arbitrary. For the purpose of this paper it is proposed that the average grant at present received by part-award-holders (£1200) should become the maximum grant received by all students whose parents have a residual income of up to £11,000, and by students independent of their parents on the present definition (about 175,000 students in total). There should then be a means test with a single gradient of £1 in £5, so that the children of parents with a residual income of over £17,000 (about 125,000) will get no grant.

6. Figure 1 (overleaf) contrasts the grant which would be available, under the proposed regime, with that provided under existing arrangements.

7. The present cost of grants is c. £480 millions. The cost of grants under the proposed regime will be c. £270 millions.

[B] BURSARIES

8. Against the background of loans for student support, and the likely desire of most students to minimise the extent of their borrowing, it will be possible to influence student behaviour in desirable directions and at low cost by the provision of selective, discretionary, bursaries.

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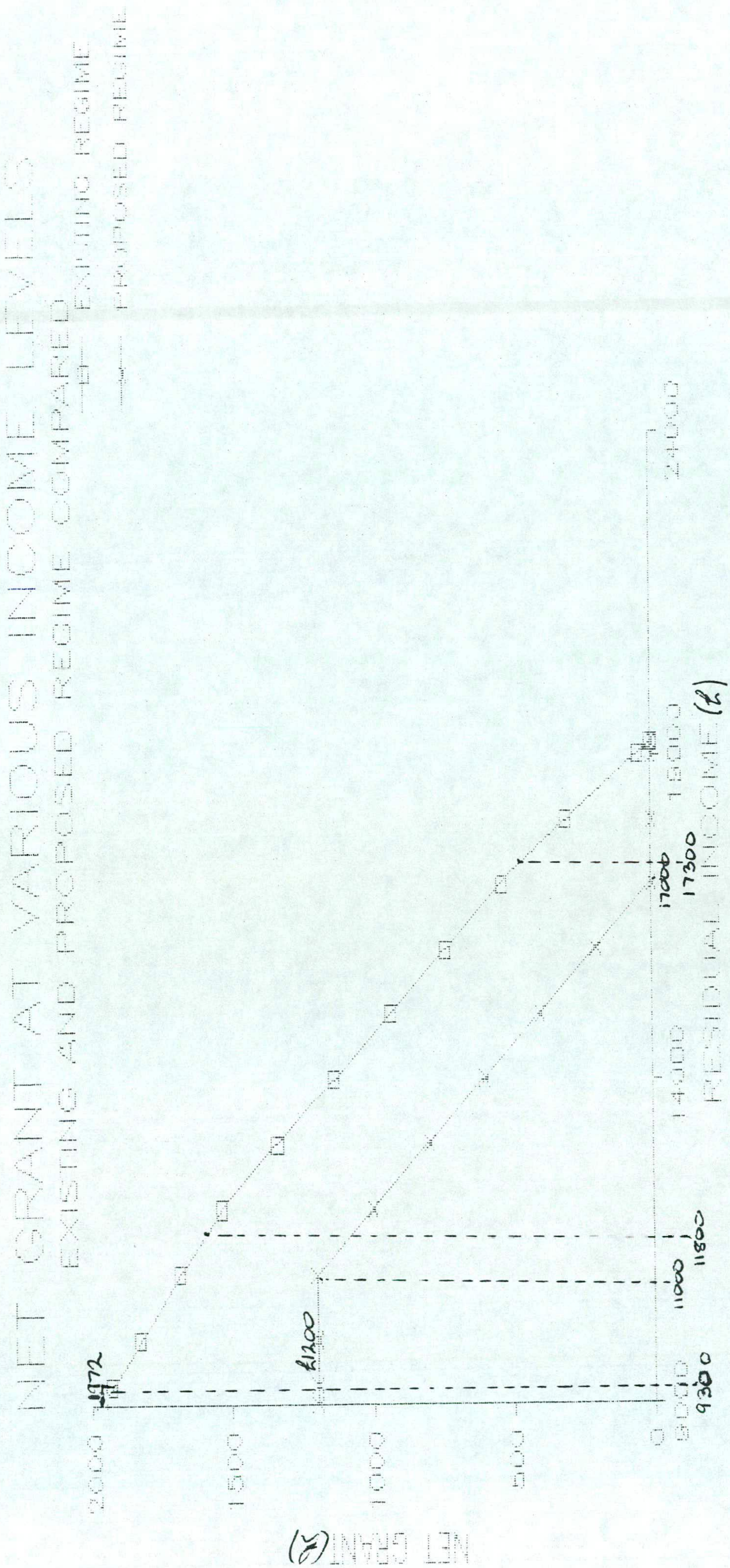
FIGURE 1



9. Such bursaries might set out to encourage academic performance by rewarding high attainment. The award could be made at matriculation or at graduation, or at both stages. If 5,000 of the 150,000 graduates each year were awarded a scholarship of £1,500 the cost would be c. £m7.5.

10. Such bursaries might also set out to encourage students to undertake the study of shortage subjects (eg. to enable them to acquire teaching qualifications, especially in mathematics, science, and technologies) or of disciplines involving long courses (eg. medicine). The total sums to be provided for this purpose would be an arbitrary amount. Carefully designed arrangements - matching funds - could bring in business sponsorship on a significant scale.

11. It would be desirable to provide discretionary bursaries to encourage "access" to higher education: this could be done, for example, by supporting some students on "access" courses. Again, the total would be an arbitrary amount. £1000 p.a. for 15,000 students on "access" courses would cost c. £m15.

[C] LOANS

12. Each student would have a loan facility equivalent to the difference between grant entitlement and a fixed sum, say £2,400. The sources of student support (in England and Wales, 1987-88) which would be replaced by the availability of loan finance under the proposals in this paper are:

a. social security benefit - £m85

b. the deemed contribution from parents, spouses and independent students - £m340.

In addition, loan finance would replace some £m210 of the amount at present laid out on mandatory grants. (See paragraph 7 above). Savings resulting from a reduction in covenanting would vary according to the take-up of loans: perhaps between £m30-50.

13. With no element of subsidy, the theoretical maximum size of the loan "fund" would thus be £m905. Retaining £m480 for providing subsidies, the loan "fund" would amount to £m425.

14. It would be desirable to make provision for the deferment of loan repayments for graduates whose income falls below a given proportion of average earnings - to take account of the problem, among others, of married women who leave the labour market to bring up their families. This concession would reduce the default rate. It would yield savings in the short-term because the burden on the Exchequer would also be deferred; in the very long term the cost would be well over £m100 with 60% take-up of the loan facility.

Public or private sector loans?

15. If the loan "fund" is operated in the public sector there will be a net short-term addition to public expenditure of some £m340 - the cost of replacing the deemed contribution from parents and others with eligibility for a loan (the loan "fund" would be larger to the extent that the amount of grant is reduced as proposed above).

16. This is a price worth paying for the following benefits: (i) Students removed from the benefit offices; (ii) Students obliged to evaluate their personal investment in higher education; (iii) The solution of the potential problems associated with the growth of the deemed parental contribution; (iv) The possibility of reducing the cost to public funds of grants below the present £m480.

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17. <u>If, however, it were concluded that in spite of these benefits an increase of some £m340 to public expenditure was not justified, the alternative of a loan "fund" in the private sector should be considered</u>.

The general characteristics of a private sector loan scheme

18. The simplest form of private sector arrangement for loans to students would be to leave it to individual students to negotiate finance on terms to be agreed with any financial agency willing to lend.

19. The government should, however, ensure that private loan finance is available to all eligible students to the level they require (up to a maximum) and on reasonable terms as to interest rate and repayment.

20. It is open to government to seek to promote arrangements between students and private agencies which would attain this objective; and, if necessary, to make a financial contribution to that end.

21. The fact that the government has persuaded such financial agencies to lend their own money to students should not be deemed to turn the resulting scheme into a public sector operation - any more than the fact that there are export credit guarantees is deemed to turn into public expenditure the total amount of export finance "triggered" by such guarantees. In both cases, the only charge to public expenditure is the amount of public money (if any) represented by the guarantee.

22. Nor should it be relevant that in persuading private agencies to lend to students the government is influencing the direction of the flow of private credit. This is not regarded as an objection to the existing practice of deeming in law that parents are making a precisely calculated contribution to the support of their student children. Nor is it an objection to export credit guarantees, or to tax

subsidies for housing finance. In all such cases, the government exerts its influence because it is persuaded that worthwhile social/economic objectives will be served by it.

23. The bottom line is that no particular private sector agency should be forced to lend to students; and no student should be forced to borrow. Any transaction within the terms of the proposed arrangements will therefore be a private transaction.

Options for a private sector loans scheme

I: BANK LICENCES

24. The government organises a competition among banks and building societies to provide student loans under licence for a period of time. A condition of the award of the licence is an obligation to lend in every case (the student to have discretion up to a stated amount for a minimum period of time). Banks and building societies would probably be prepared to compete in these circumstances only if the licence gave them a monopoly of the business: this would enable the licensed bank or building society to offset the profits that it makes on some loans against the losses it suffers on others. The government's objective of free competition would be preserved through the negotiations for the award of the licence, and by keeping the period until renewal as short as possible. It might even be feasible to award a number of licenses for different universities or groups of universities, with a separate competition for each.

25. The problem in such a scheme lies in the enforcement of the monopoly, wherein lies the attraction to the tenderers. This could be met either by granting a statutory monopoly for the period of the licence: this would probably be unenforceable. Or it could be met by providing an element of government interest rate subsidy to students borrowing from the licensed agency, thus building in such an incentive

to borrow from that agency as will, in practice, give it a monopoly status.

II: POOLED INSURANCE

26. The risk of an obligation to lend to any student seeking a loan is a risk which can be insured against by purchasing insurance against the risk of default, death, etc.

27. Private agencies agreeing to participate in running a private sector loans scheme could agree among themselves to pool this risk by contributing to purchase insurance against that risk. They would then compete to lend. The cost of this insurance would be passed on to the borrower. This would represent an additional potential cost on each student loan, but it might not represent an actual cost, as the credit risk of providing the average of individual loans would be reduced as a result: interest rates would therefore also be reduced, possibly by an amount which was on average equivalent to the insurance provision. Government could further reduce this charge to the student by contributing to the cost of the insurance premium. Large employers of highly-educated labour might also join in such an exercise.

28. The government's contribution to the purchase of the insurance premium would constitute the total public expenditure cost of this operation.

III: GOVERNMENT GUARANTEES

29. Under a scheme for government guarantees, the government would in effect undertake to cover the cost of the pooled risk described in paras 26 and 27 above. It would pay a proportion - to be negotiated - of the cost of each default, death, etc., arising in respect of a portfolio of student loans offered by an agency participating in the scheme. The agencies would compete to lend; and they would have an incentive to pursue defaulters to the extent to which each loan is uncovered by guarantee.

30. There would be a contingent liability against public expenditure in respect of the government's total "exposure" under this scheme; and an actual claim on public expenditure to the extent of any default, death, etc.

Subsidies to a private sector scheme

31. These three options for a private sector loan scheme disclose a variety of possibilities for a government subsidy to improve the terms of borrowing to the student. (Any such subsidy could be financed from the £m565 currently charged to grants and student social security benefits.)

a. Under the bank licence scheme the interest rate charged by the successful tenderer could be reduced by x points below the market rate. This would reinforce the favourable effects of the competition for the licence.

b. Under the pooled insurance scheme the interest rate to students could be kept down by a government subsidy to the cost of the insurance premium. This could reduce the interest rate for student borrowing - risk-free to the lender - below the market rate. Meanwhile the lenders would compete for student custom by holding down their rates.

c. Under the guarantee scheme interest rates could be kept down either by a direct subsidy to lenders, or by the operation of a government guarantee. Competition would also operate to keep down interest rates, if the government subsidy took the form of a fixed percentage interest rate subsidy.

Repayment

32. Loans will be repayable by students. Only if a student defaulted would the risk fall on the guarantor or the insurance pool. But companies that employed graduates who had

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drawn loans under the scheme would have the option of taking over the loans and repaying them themselves, or of taking part of the debt burden off their new employees. This would open up the prospect of an extensive growth of private sponsorship of students.

The costs to borrowers of a private sector loans scheme

33. The cost to graduates of a private sector loans scheme will obviously depend upon (i) the extent to which a particular student benefits from a direct subsidy by way of grant, bursary, etc; (ii) the extent to which competition improves the terms of lending; (iii) the extent of any indirect subsidy to interest rate, etc; and (iv) the cost of administration.

34. It is not obvious that student borrowers would get better terms from a public sector loans scheme. While it is arguable that, because of the government's superior attraction as a borrower, it would be able to lend cheaper than any private sector agency, it is also arguable, on the other hand, that costs in the private sector would be lower because their arrangements would be more effectively managed, and defaulters would be more effectively pursued. There is, besides, a political presumption in favour of the competitive private sector.

35. To set the issue in context, Figure 2 illustrates the extent of the average loan obligation on graduates in countries operating loans schemes. It also compares interest charges, default rates and numbers of students involved.

The Public Expenditure Cost of a Private Sector Loan Scheme

36. The following tables display, under various assumptions, the characteristics of the kind of grants/loan scheme discussed in this paper.

37. The constant assumptions are

a) Grants as at paragraph 5 above (ie maximum rate of £1,200, cutting off at a parental income of £17,000 p.a.).

b) 395,000 students eligible to borrow up to £2,400 p.a.

c) students' repayments begin 2 years after graduation,

d) a default rate of 10%

e) deferment of loan repayments for graduates whose income falls below 85% of average earnings,

f) steady state is reached by year 26,

g) students' repayments cover inflation.

Further details about the model are given in the note which follows the tables.

38. The variable assumptions are

a) take-up of the loan at 80%, or 60%, or 40%. (Take-up will depend upon such factors as the availability of grants, bursaries, and sponsorship, and the level of student earnings and of parental contributions)

b) the extent of interest rate subsidy

c) the extent of the deferral of interest liability - is interest to be borne from the start of the loan, or from two years after any deferral period?

d. whether the loan is protected by Government guarantee or by the private sector through, for example, some sort of insurance scheme such as that described in paragraphs 26-28 above.

39. Across the whole range of these various assumptions the following features emerge.

a) there is a considerable saving to public expenditure under the scheme throughout the period reviewed except in the very long term under option II with 60% or 80% take-up and under option III with 80% take-up.

b) the profile of such saving over time follows an identical pattern - initial high savings in real terms followed by a decline from year 5.

40. This profile suggests that our scheme could be designed, with substantial political advantage, to start with a freight of grants, bursaries and matched funds for sponsorship which could be lightened year by year as the interest rate subsidy comes to be more expensive.

DEPARTMENT OF EDUCATION AND SCIENCE
DECEMBER 1987.

OVERLEAF: FIGURE 2 COMPARES LOANS SCHEMES IN VARIOUS COUNTRIES, INCLUDING LEVELS OF INDEBTEDNESS, INTEREST RATES, DEFAULT RATES AND NUMBERS OF STUDENTS INVOLVED

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FIGURE 2

Country	Scheme	Average total debt at start of repayment £	Interest(5) charges and period of application	Default rate	Number of students involved (Proportion of all full-time first degree students)
anada(1)	Canada Student Loans Provincial Loans	2000 1400	10.375% from start of repayment n.a.	9% n.a.	117k(30%) n.a.
enmark(2)	Government Loans Government Guaranteed Bank Loans	3000 n.a.	4% during course, 8% thereafter 11.5-13.5% during course, 12.5-14% therafter	<10%	11.4k(13%) grants & government loan 14.4k(16%) grants, gov loan & bank loan 4.2k(5%) bank loan only
rance(1)	Government Loans Parental Guaranteed Bank Loans	2400 4500	Free 9-15%	n.a. n.a.	3.5k(<1%) 58k(6%)
apan(2)	Japan Scholarship Foundation	5600	Free 3% from start of repayment	2.3%	228k(12%)
etherlands(3)	Government Loans	1800	6% from start of repayment	n.a.	n.a.
orway(2)	Government Loans	7000	11.5% from end of course	<1%	54k(59%) grants and loans 6.4k(7%) loans only
weden(2)	Government Loans	12500	4.2% from time of loan	2%	103k(89%) grants and loans
S A(1)	Guaranteed Student Loan Program Parent Loans for Undergraduate Students National Direct Student Loans	5000 5000 2000	8% for 4 years from start of repayment, 10% thereafter 12% from start of repayment 5% from start of repayment	7% n.a. 13%	3.7m(49%) 780k(10.5%)
est Germany(2)	Government Loans	8300(4)	Free	<1%	460k(33%)

) Based on 1984/5 figures. (2) Based on 1985/6 figures. (3) Based on 1986/7 figures.

) The top 30% academically will have this reduced by 25% and other substantial reductions in debt are available.

) As far as we have been able to ascertain, these are the actual rates paid by the student - i.e. nothing is added to cover inflation.

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OPTION I

1. The main features are:

- a privately funded loans scheme,
- Government guarantee,
- Government subsidy to interest repayments.

2. The main assumptions are:

a. real interest rate is 4% throughout;

b. students pay half of that, i.e. 2%, during repayment period;

c. Government pays full real interest rate during the course, the 2-year grace period and any deferral periods, as well as the cost of default.

3. The main points emerging from the calculation are:

i. interest subsidy increases exponentially, but even with 80% take-up, even at the steady state, is significar less than the net saving of grant and benefits;

ii. the total saving to the taxpayer is still respectable, nearly £150m. with 80% take-up and over £180m. with 60% take-up after 15 years.

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OPTION I : PRIVATELY FUNDED LOANS SCHEME · GOVERNMENT GUARANTEE AND SUBSIDY

DETAILED ASSUMPTIONS

4% real interest rate assumed throughout course, grace period, periods of deferral and repayment. Students pay 2% during repayment period only. Government pays remainder of interest and cost of default (10% default rate is assumed). Conventional deferral assumptions adopted.

	TAKE-UP	COMPONENTS OF PSBR EFFECT	YEAR 1	5	10	15	Steady State	Net Present Value (Yrs 1-35)
(i)	40%	Net change in grant/SB	-304	-304	-304	-304	-304	
		Default cost	0	+2	+14	+27	+37	
		Interest subsidy	0	+4	+29	+63	+105	
		Total	-304	-299	-261	-215	-162	-3,428
(ii)	60%	Net change in grant/SB	-317	-317	-317	-317	-317	
		Default cost	0	+3	+21	+41	+56	
		Interest subsidy	0	+5	+44	+94	+157	
		Total	-317	-308	-252	-182	-104	-3,598
(iii)	80%	Net change in grant/SB	-329	-329	-329	-329	-329	
		Default cost	0	+4	+28	+54	+75	
		Interest subsidy	0	+7	+59	+126	+209	
		Total	-329	-318	-242	-149	-45	-3,268

OPTION II

1. The main features are:

   - a privately funded loans scheme,
   - protected by private insurance scheme, not Government guarantee,
   - small Government subsidy to interest repayments.

2. The main assumptions are:

   a. real interest rate is 7.5% throughout;

   b. students pay most of that, viz. 6%, during repayment period;

   c. Government pays full real interest rate during the course, the 2-year grace period and any deferral periods.

3. The main points emerging from the calculation are:

   i. interest subsidy dominates the calculation by the time a steady state is reached, except where take-up is unrealistically low at 40%;

   ii. despite students paying so high a proportion of the real interest rate, savings to the taxpayer are less than under option I.

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OPTION II : PRIVATELY FUNDED LOANS SCHEME : GOVERNMENT SUBSIDY ONLY

DETAILED ASSUMPTIONS

7½% real interest rate assumed throughout course, grace period, any periods of deferral and repayment period. Students pay 6% during repayment period only. Government finances the remainder (1½% during repayment period, 7½% during course, grace + deferral periods). No Government guarantee. (conventional deferral assumptions adopted.

	TAKE-UP	COMPONENTS OF PSBR EFFECT	YEAR 1	5	10	15	Steady State	Net Present Value (4/1-30)
(i)	40%	Net change in grant/SB	-304	-304	-304	-304	-304	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+6	+54	+121	+228	
		Total	-304	-298	-251	-183	-77	-3,423
(ii)	60%	Net change in grant/SB	-317	-317	-317	-317	-317	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+9	+81	+182	+341	
		Total	-317	-307	-236	-135	+25	-2,841
(iii)	80%	Net change in grant/SB	-329	-329	-329	-329	-329	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+12	+107	+243	+455	
		Total	-329	-316	-221	-86	+126	-2,259

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OPTION III

1. The main features are:

- a privately funded loans scheme,
- protected by a private insurance scheme, not Government guarantee,
- Government subsidy to interest repayments,
- students begin to pay their share of the real interest from the time they take out their loan.

2. The main assumptions are:

a. real interest rate is 7.5% throughout;

b. students pay less than half of that, viz. 3.5%, througho period of loan;

c. the Government pays 4% of real interest.

3. The main points emerging from the calculations are:

i. interest subsidy increases exponentially but remains significantly less than the saving after 15 years;

ii. interest subsidy outweighs the saving in the steady state only if take-up is as high as 80%.

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Option III : PRIVATELY FUNDED SCHEME : GOVERNMENT SUBSIDY ONLY

DETAILED ASSUMPTIONS

7½% real interest rate assumed throughout course, grace period, any periods of deferral and repayment period. Students pay 3½% throughout all periods. Government finances the remainder (4%). No Government guarantee. Conventional deferral assumptions adopted.

	TAKE-UP	COMPONENTS OF PSBR EFFECT	YEAR 1	5	10	15	Steady State	Net Present Value (Yrs 1-35)
(i)	40%	Net change in grant/SB	-304	-304	-304	-304	-304	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+6	+51	+110	+193	
		Total	-304	-298	-254	-194	-111	-3,617
(ii)	60%	Net change in grant/SB	-317	-317	-317	-317	-317	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+9	+76	+165	+290	
		Total	-317	-307	-240	-152	-27	-3,131
(iii)	80%	Net change in grant/SB	-329	-329	-329	-329	-329	
		Default cost	0	0	0	0	0	
		Interest subsidy	0	+13	+102	+220	+386	
		Total	-329	-316	-227	-109	+58	-2,645

THE STUDENT LOANS MODEL **CONFIDENTIAL**

1. A model is a simplification of the real world. The present model allows us to see quickly the broad consequences of alternative loans schemes. But its simplifications are bound to distort reality in some respects.

Main features of the model

2. The model projects loan repayments, in real terms, over 35 years, on the basis of assumptions about:

- average value of loans,
- numbers of students completing studies in each year,
- terms of repayment,
- default rate,
- take-up rate.

Graduates are normally assumed to make equal repayments, in real terms, over 10 years. These represent repayment of both principal and accrued real interest throughout the term of the loan.

3. Additional assumptions concern:

- a "grace period", i.e. no repayments for a short time after course completion,
- deferral of repayments when a graduate's income falls below a given threshold.

Deferral is calculated by phasing in repayments on the basis of known information on graduate earnings profiles. Thus repayments in respect of 50 per cent of the debt incurred by leavers in a given year commence on the third year after graduation, continuing for 10 consecutive years thereafter. Repayments in respect of a further 10 per cent of the debt commence on the fifth year after graduation and so on.

Limitations

4. The structure of the model derives from a hypothesis that the loans scheme will be publicly funded. It is a consequence of the way the model works that, in using it to illustrate the effects of a privately funded scheme the commercial real interest rate has been implicitly assumed to be sufficient to induce the commercial lenders to accept deferral of their repayments (with full accrual of interest in the mean time).

5. A further consequence is that the Government subsidy begins to apply only when graduates start their repayments: the real interest therefore builds up, at compound rate, during the course and any grace and deferral periods. It would be more realistic to assume, say, that the Government would meet its share of the real interest rate annually during these periods: such an assumption would reduce the long-term costs to the taxpayer.

CONFIDENTIAL

6. The model applies a loans scheme to all students from the first year. It would be more realistic to assume that students already on courses with grants would continue with grants until the end of their courses: only new students would have loans. To build in this latter assumption would reduce the savings to the taxpayer in the short term, that is, during the years which are the focus of the Public Expenditure. A more refined model could give more realistic figures for each of the years 1-5.

Economics Division/FHE3
December 1987

RM2.61

CONFIDENTIAL

PMP -

FROM: MOIRA WALLACE
DATE: 18 January 1988

PS/PAYMASTER GENERAL

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Gilmore
Mr Burr

REVIEW OF STUDENT SUPPORT

The Chancellor has seen Mr Burr's minute of 14 January. He would be grateful for the views of the Paymaster General and the Economic Secretary as soon as possible.

MPW.

MOIRA WALLACE

3977/40

CONFIDENTIAL

FROM: P J CROPPER
DATE: 20 January 1988

CHANCELLOR

[Cropper wants loans to replace parental contribs + soc sec, but not - initially - grants, & a public sector scheme.]

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

REVIEW OF STUDENT SUPPORT

You have invited Ministers and Advisers views on Student Loans in the light of Mr Burr's minute to you of 14 January, covering Robert Jackson's paper.

2. I believe there are some fundamental decisions to be taken here: without them, no further progress can be achieved. The following views are personal: I do not think one can identify any single Conservative position that might guide us towards decisions.

3. My belief is that students over 18 are adults and should be treated as adults. They are, almost by definition, that section of their age-group most likely to be capable of conducting their own lives: it is for the older adults to ensure that they do. That, I believe, means bringing home to students the cost of the training they are getting, and the importance of relating that training to their subsequent careers. This connection is more likely to be achieved by a market-based system of student finance than by any other, and I see student loans as the key. Higher education is a form of investment: it is reasonable that it should be financed by borrowing.

4. The only question is, who borrows how much, and from whom? I believe it is the student who must borrow, not the State or the parent. How much? In the long run the objective should be to transfer the whole cost of higher education

CROPPER TO CX 20 JAN

to the recipient, but I would start with maintenance. The cost of tuition can conveniently be left until much later. From whom? I come down firmly on the side of a public sector loan fund to start with, because I do not think we can allow interest to roll up at full market rates on student loans and I do not like messy arrangements where commercially negotiated arrangements are subsidised by the State. The remaining question is whether such a scheme could be launched fully fledged, or whether it would have to be introduced gradually.

5. My own view, which will not be popular with the Public Expenditure side, is that we should start by offering loans in lieu of parental contribution and in lieu of social security drawings. In this way we will launch the scheme among the better off people, who will be more familiar with the concepts involved. And we will launch it with families where, if they have strong objections to the loan idea, the parents will have the option of financing their children's education out of their own pockets. Starting off with loans in lieu of grant would be starting off with just the wrong people, those where the parents are at the lower end of the income scale.

6. As to the public expenditure problem, it seems to me that a successful loan scheme would be a very great prize in so many ways that we should be prepared to pay up. In any case, it is a loan scheme so that after a few years the repayment of loans will bring about an equilibrium state.

7. I cannot see that Robert Jackson can go any further until he knows:

(i) whether the Treasury is prepared to finance or guarantee the loan fund.

(ii) whether we would want to appoint financial institutions as agents or whether a special body, akin to the Agricultural Mortgage Corporation, should be set up.

(iii) whether we are prepared to subsidise the interest rates.

(iv) at which end of the spectrum the whole thing is going to start - by replacing grant, parental contribution or social security top-up?

8. Given the time constraints described by Mr Burr, it looks to me as if top-level discussion is urgently due.

PJC

P J CROPPER

CONFIDENTIAL

pmg

Inland Revenue

Policy Division
Somerset House

Perhaps we could deal with this note at your maintenance relief meeting in the morning. 6WB 21/1

FROM: C STEWART

DATE: 21 JANUARY 1988

1. MR CORLETT
2. MR ISAAC 21.1.
3. FINANCIAL SECRETARY

STUDENT COVENANTS

1. At the Chancellor's meeting on 15 January Ministers favoured a scheme with two grant/contribution scales (Option 3 in my note of 7 January), but with no minimum grant. But we were asked to consider the Economic Secretary's suggestion that as an alternative way of preventing students getting a double benefit during the transitional period, part of the student's grant could be set off against the tax repayment due on his covenant.

2. We assume the Economic Secretary's scheme would work as follows -

a. tax relief for pre-Budget covenants would continue;

b. a single (increased) grant scale would apply to both old and new students; but

c. students with pre-Budget covenants would have the tax repayment on their covenant reduced by the equivalent of the extra grant.

---

cc		
	Chancellor of the Exchequer	Mr Battishill
	Chief Secretary	Mr Isaac
	Paymaster General	Mr Corlett
	Economic Secretary	Mr Beighton
	Sir Peter Middleton	Mr Calder
	Mr Anson	Mr Davenport
	Mr Scholar	Mr Stewart
	Mr Culpin	Mr Yard
	Miss Sinclair	Mr Golding
	Mr Burr	Mr Boyce
	Mr Cropper	Miss Dougharty
	Mr Tyrie	Mrs Fletcher
	Mr Jenkins (Parliamentary Counsel)	PS/IR

STEWART TO FST 21 JA

STUDENTS

3. Thus in the income range where the new scale reduced parental contributions (and so increased the grant) by the full 27%, the grant increase would equal the tax repayment and reduce the tax repayment to nil. (This assumes that the covenant payment exactly equals the assessed parental contribution. In practice this is not always so.)

4. In the income range where the parent's contribution was reduced, but by less than 27%, the student's tax repayment would be correspondingly reduced but not wiped out altogether.

5. From a fiscal policy point of view, the suggestion is not ideal. The grant increase would remain public expenditure. The reduction in the tax repayment would be an increase in the tax yield. So compared with Option 1 in the 7 January paper, there would be no saving in public expenditure, but there would be a higher tax yield.

6. Administratively, there would be considerable extra work and complexity for students and this Department, and possibly for local authorities. In order to reduce the tax repayment, we would need to know whether the student was receiving a maintenance grant, and if so how much (and for what period). This is not information we get from the student at present. Since the aim would be to claw back the increase in the grant, we would need to establish how much the grant had increased because of the change of system. The increase would presumably be calculated by reference to a hypothetical "old" scale. This would have to be done for several years, as pre-Budget students may well continue to get grants and covenant relief for a number of years (for example the medical student who started in Autumn 1987).

7. One possible short-cut would be for the grant increase as measured in the first year to be taken as the "increase" for subsequent years as well. But that could give unfair results in some cases, because the level of grant in an individual case may vary from year to year anyway because the parent's income goes up or down.

8. It would be necessary to legislate to specify how the amount to be set against the tax repayment was to be calculated. There would probably have to be provision for the Revenue to obtain information from the local education authority where there was any doubt about the figures put forward by the student himself.

9. Once the amount of the grant increase was determined, it would still be necessary to say how this affected the tax repayment if the student had other income - such as vacation earnings. The students gets his tax repayment on a covenant by setting the covenant payment against his personal allowances. If his personal allowances were already fully used against vacation earnings, there would be no tax repayment on the covenant, and so the grant increase would not be clawed back. Alternatively, if the rule was that the personal allowances had to be set against the covenant payment first, the grant increase would be clawed back; but students would no doubt complain that they were being denied the covenant repayment but prevented from using their personal allowances against other income either.

X

<u>Conclusion</u>

10. Clawing back the grant increase through the tax system in this way would mean that the pre-Budget student with a covenant did not obtain a double benefit. And because the higher grant was paid to everyone, the pre-Budget student who did not have a covenant would benefit from the grant increase (which he would not do under our Option 3).

11. But for the reasons set out above, the scheme would be complex to run and lose us much of the early benefits of staff savings. Moreover, the Chancellor indicated at the meeting that he did not feel there was any particular need to compensate existing students who could have had a covenant before Budget Day but had not done so - in which case Option 3 achieves the desired result.

I have to say that this still looks like a nightmare; and X would be even more difficult with the (very common for students) instalment claims.

CS

C STEWART

CFER 21.1

(I have to say that this still looks like a nightmare; and X would be even more difficult with the (very common for students) instalment claims.)

53/2/MAD/3749/29

Mr Burr (15/1?)

CONFIDENTIAL

FROM: ECONOMIC SECRETARY
DATE: 25 January 1988

CHANCELLOR

[EST wants loans in place of (i), (ii) & (iii) below, but not (iv).]

cc Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Call
Mr Tyrie
Mr Cropper

EST TO CX 25 JAN

ECONOMIC ASPECTS OF STUDENT LOANS

1. At present there are six sources of finance for student maintenance:

(a) Public sources:

(i) grant,
(ii) social security benefits,
(iii) covenant tax relief,

(b) Private sources:

(iv) parental contribution,
(v) student borrowing (unsubsidised)
(vi) student earnings.

2. The proposals involve a seventh type of finance - state subsidised student loans. This is a hybrid involving both public and private finance. (The subsidy is public, the repayment is private and the loan may be either depending on the organisation of the scheme).

3. Subsidised student loans may replace either public sources of finance or private sources or both. Our objective should clearly be that any state loan scheme should mainly replace the three public sources of student support. Grants and social security benefits are obviously burdens on the taxpayer, which also encourage 'welfare

CONFIDENTIAL

dependence' among the youthful intelligentsia. But covenant tax relief is also damaging in that it distorts the choice between reliance on parental contribution and working - because of lost personal allowance - and, to a lesser extent, student borrowing.

4. I can see only two serious reasons for offering subsidised student loans as an alternative to parental support:

(i) to help students whose parents refuse to cough up their parental contribution. However, it is not possible to help the few with irresponsible parents in this way except at the expense of encouraging all parents to abandon their responsibilities,

(ii) as a sweetener to accompany a shift from grants to loans.

5. There is no socio-economic case for encouraging a shift away from the three private sources of finance to subsidised loans. The Jackson proposals implicitly assume student borrowing is 'better' than parental contribution. A large part of the cost of his proposals is the cost of subsidising a shift from parental contribution to loans. The implied benefits are:-

(i) loans make students recognise that benefits have a cost - "money does not grow on trees" - instead of their first experience of adult life being an apparently costless existence subsidised by parents plus the state;

(ii) loans would make students treat their education as an investment in remunerative qualifications rather than the consumption of leisure.

6. But it is paradoxical to suggest that giving students and their families the additional alternative of subsidised loans would make them less reliant on subsidies. Any gain in realism among students must be lost by increasing the subsidy culture among their parents. Indeed, since most of the cost of subsidy will reflect

the cost of default we would be subsidising defaulters who would otherwise have been funded by their parents.

7. The Cropper view that the move from dependence on parental support to dependence on state support (ie relying on other people's parents) constitutes a move towards independence is an uncharacteristic delusion! Moreover it is a noxious doctrine that family ties should be severed at 18.

8. Mr Jackson argues that it does not matter if subsidised student loans replace private finance (parental grant) so long as those loans are themselves privately financed. This is clearly not true. We operate within a notional money GDP constraint. So if an extra £x million is lent to students a corresponding £x million reduction in money spending must be achieved elsewhere (by higher interest rates or taxes) - regardless of whether the £x million of loans was private lending or straight from the Public Works Loan Board! So the immediate economic cost of a subsidised student loan scheme - even if the loan is classified as private - is not measured just by the cost of the subsidy. The cost also includes the marginally higher interest rate (or taxes) born by all other borrowers (or taxpayers).

[illegible]

9. Mr Jackson responds to these arguments by saying that parents, relieved of their need to make a parental contribution, may increase their savings so that total spending will not rise - at least not by £x million. This is clutching at implausible straws. Any increase in parental savings would only be a second order effect.

Of course, as loans are repaid that reverses the demand effect. So over the lifetime of a loan the only economic cost is the subsidy.

10. Mr Burr's assessment in his paper of 5 November 1987 of whether the whole value of the loan should count as public expenditure or just the subsidy cost seems sensible. If the Government determines who qualifies and how much each individual can borrow and it bears most of the risk of default; the banks are mere agents for the Government, effectively lending to it. So the loans are part of Government spending. However, if the Government just

subsidises the interest rate while the Bank has discretion (within certain categories) as to how much to lend, to whom and bears the risk of default, the loans are private. In that case only the interest rate subsidy is a public spending cost. Brilliant?

Guy Westhead

pp PETER LILLEY
(approved by the Economic Secretary and signed on his behalf to reduce delay)

MC22

CONFIDENTIAL

Pps ...

pmp

FROM: MARK CALL
DATE: 26 JANUARY 1988

CHANCELLOR

Ch/ you have papers

mpw

27/1

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Cropper
Mr Tyrie

CALL TO CX 26 JAN

STUDENT LOANS

1. I agree wholeheartedly with the Economic Secretary's reservations (his minute to you of 25 January) about subsidised loans replacing any of the sources of private finance for student support. The introduction of loans should be clearly linked with the reduction or elimination of public sources of finance. Of these the eligibility for social security benefits is key. The entitlement to benefits ~~about~~ without ever having contributed is a poor preparation for the enterprise economy.

?? 2. I cannot believe that we would seriously entertain the idea that the Government would determine who would qualify for a loan, how much each individual could borrow, as well as carry the risk of default. I can already hear the cries of "centralism!". The highly desirable <u>principle</u> of loans would not be worth the price -a classic case of throwing the baby out with the bathwater. While subsidising the rate of interest also offends my market principles, I can see that this may be needed to sell the scheme politically and give it a kick-start. If we go that route, we may wish to take care to leave the door open for conversion to market rates in the future.

3. One likely development from loans which would be welcome would be the practice whereby some (although probably not many) employers would pay off the recruited student's loan. Even though this may

not (could not) become the norm it would be the beginning of a market mechanism working to ensure a better fit between the needs of industry and the output of the universities. Employers might choose to pay off loans only for "appropriate" degrees, however they defined that. Given that this is likely to be operated by only the larger employers, which have greater lobbying power with the universities, it would have an effect disproportionately larger than the proportion of loans paid off. The introduction of loans should thus be popular with the larger employers and no doubt with the CBI.

MC

MARK CALL

010/4209

CONFIDENTIAL

FROM: **CHIEF SECRETARY**
DATE: **26 January 1988**

CHANCELLOR

cc:
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Call
Mr Tyrie
Mr Cropper

Ch/ You have previous papers. Would you perhaps like a short meeting (although we do need to give DES a steer soon)? MPW 26/1

CST TO CX 26JAN

REVIEW OF STUDENT SUPPORT

You have invited views on Robert Jackson's Paper and Tim Burr's covering minute of 14 January.

It seems to me there are several fixed points.

1. To move from Grants/Parental Contribution to loans is a structural change. It will generate strong opposition inside and outside the House. The Keith Joseph experience -though not analogous - reinforces this view. But times are changing and the fuss should be bearable.

2. To establish the principle of loans is a great prize that can be built on in the future.

3. The removal of students from Social Security entitlement is necessary and overdue (i.e. housing benefit, unemployment benefit in long vacations etc).

4. We should not jeopardise these prizes by over ambition.

5. We need to present proposals speedily if we are, to legislate next session. (Not absolutely essential but certainly desirable).

CONFIDENTIAL

This seems to me to argue broadly in favour of a derivation of the line Tim Burr suggests.

At present students receive 'free' tuition , grants (with or without parental contribution) for maintenance, some social security benefits, and no loan entitlement. The full cost is met by the taxpayer and parent. There is no student contribution although he/she is the beneficiary.

In real or nominal terms?

I see a way through here. I would 'freeze' the present grant entitlement at (or below) present levels and then progressively reduce it. I would reduce the present parental contribution as an initial sweetener with the option of phasing it out entirely at a later stage. And I would introduce loans to replace the diminished parental contribution and supplement the reducing grant.

I fear, in the first instance, a Public Sector Loan Scheme is necessary at a zero real terms interest rate; my proposal introduces a front end public expenditure cost but one which is probably necessary to 'sell' the scheme politically. If that judgement is right, it is a worthwhile front end cost and I have asked officials to cost options.

We clearly need to decide this speedily.

John

JOHN MAJOR

CONFIDENTIAL

① Julie - papers for student mtg notice, if you want

FROM: PAYMASTER GENERAL
DATE: 27 January 1988

② back to LM.

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Cropper
Mr Tyrie
Mr Call

BF to me 3/2

Must we pursue!

A mtg is reqd. ASAP

PMG TO CX 27 JAN

REVIEW OF STUDENT SUPPORT

You asked for views on Robert Jackson's paper. I have already seen the comments from the Chief Secretary, the Economic Secretary and Peter Cropper, and apologise for the delay in letting you have this note - caused by the need to get some data from DES.

2. Some statistics:

- 28 per cent of students are on a full grant at present, with zero parental contribution (PC);
- 26 per cent have an assessed maximum PC, and account for nearly £200 million out of a total assessed PC of £340 million;
- to comment on paragraph 4 (i) of the Economic Secretary's note, nearly half of those in receipt of PC do not receive it in full - even though we have cut the full grant (and thus the notional PC) significantly since 1979. But I do acknowledge that those who refuse to pay up anything are a small minority.

To my mind the first two points make what we do at the extremes of income important: it is not enough to design a sensible system for those with parental incomes in the £10-20,000 range.

3. As I see it, the following table shows how students are financed now, and might be financed in the future. (All figures are in current prices, and assume all students with existing covenants have worked through the system):

(£million)

	Now	Post-budget(+)	Jackson (*)	PB (†)
Grants	480	595	385	285
Social Security	85	85		
Loans made			520	395
Public expenditure	565	680	905	700
Parental contribution (PC)	340	225	-	125
TOTAL	905	905	905	905

?? + £115 million transferred from covenants relief (1991-92) to grant

* A reduction in grant of £210 million compared to previous column

† Grant as in Jackson; £100 million reduction in PC compared with post-Budget regime.

4. I do realise that £100 million of grant, £100 million of loan and £100 million of PC are not equivalent in economic or public expenditure terms. But if we are designing a new system then politically the transfers in year one between these elements are what people will concentrate on.

5. The reduction in PC of £100 million shown - which I must stress is not a firm proposal, just an illustrative figure - works out at about £330 a head, if we keep the tapers the same as they will be after the Budget (and are now, after tax). (Of course those at low incomes who make PCs of less than this sum after the Budget would have them reduced to zero.)

6. The presentational arguments in favour of a reduction in the PC are clear. A back-of-the-envelope calculation indicates that an option on these lines should reverse a good part of the "loss" (of up to £550) that will be suffered this autumn by those with incomes between £20,200 and £23,250 who lose covenant relief for new student offspring. (This loss results from our decision not to reintroduce a minimum grant.)

for lower PC?

7. These people will complain - even though they are not "losing" in any meaningful sense. Of course we have some thin ice to

get over between ending covenants and starting loans but with luck we could harness this lobby to support loans.

8. All this is set out (in very schematic form) in the two graphs attached. The first shows the present system. The second shows what we will have from this autumn (line X-X), and a possible way (using the figures in the "PB" column above) of introducing loans - in essence applying a flat-rate reduction worth about £100 million to the PC and giving Robert what he wants on grant (adjusted for the Budget covenant change). This gives a PC shown by the line P-P, and grant shown by the line G-G.

9. Permutations on this are almost endless - in particular:

a. at what income levels should any reduction in PC be concentrated?;

b. at what incomes should cuts in grants be concentrated?;

c. should there be a maximum grant for families with more than one student?;

d. or a maximum loan?;

e. or a maximum PC?;

f. or some pair of c.-e.?

10. In conclusion, I think:

a. you should write to Kenneth Baker, explaining why a public sector scheme is the only realistic option in the short to medium term;

b. the prize is a substantial shift from grant to loans; but

c. some shift from parental contribution to loan might be needed as lubrication, to enable DES to sell loans successfully; and so

d. we should consider what "initial increase" (paragraph 5 of the draft letter) might be acceptable when we have the costings the Chief Secretary has asked for.

P.B.

PETER BROOKE

FIGURE 1

CONFIDENTIAL

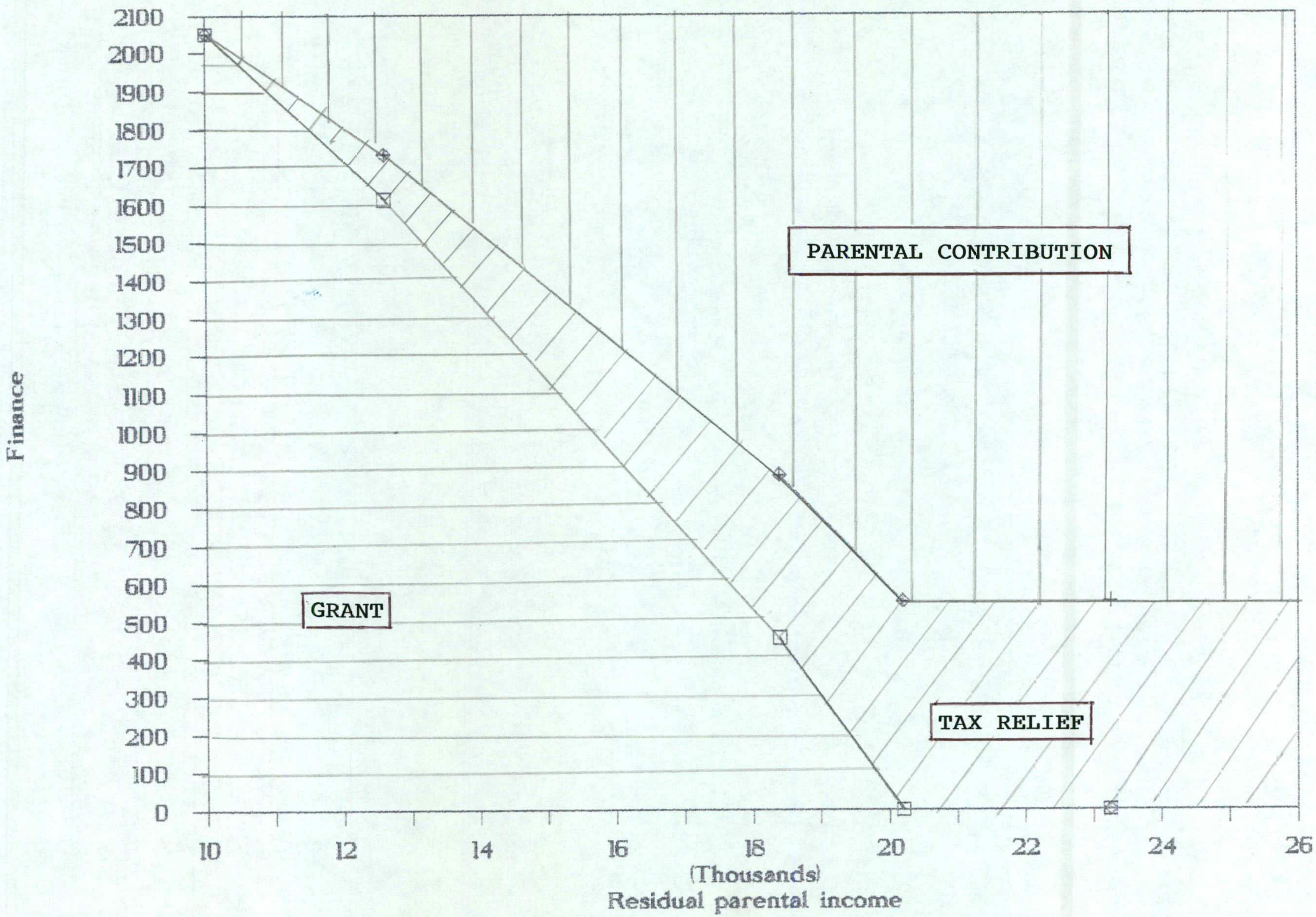
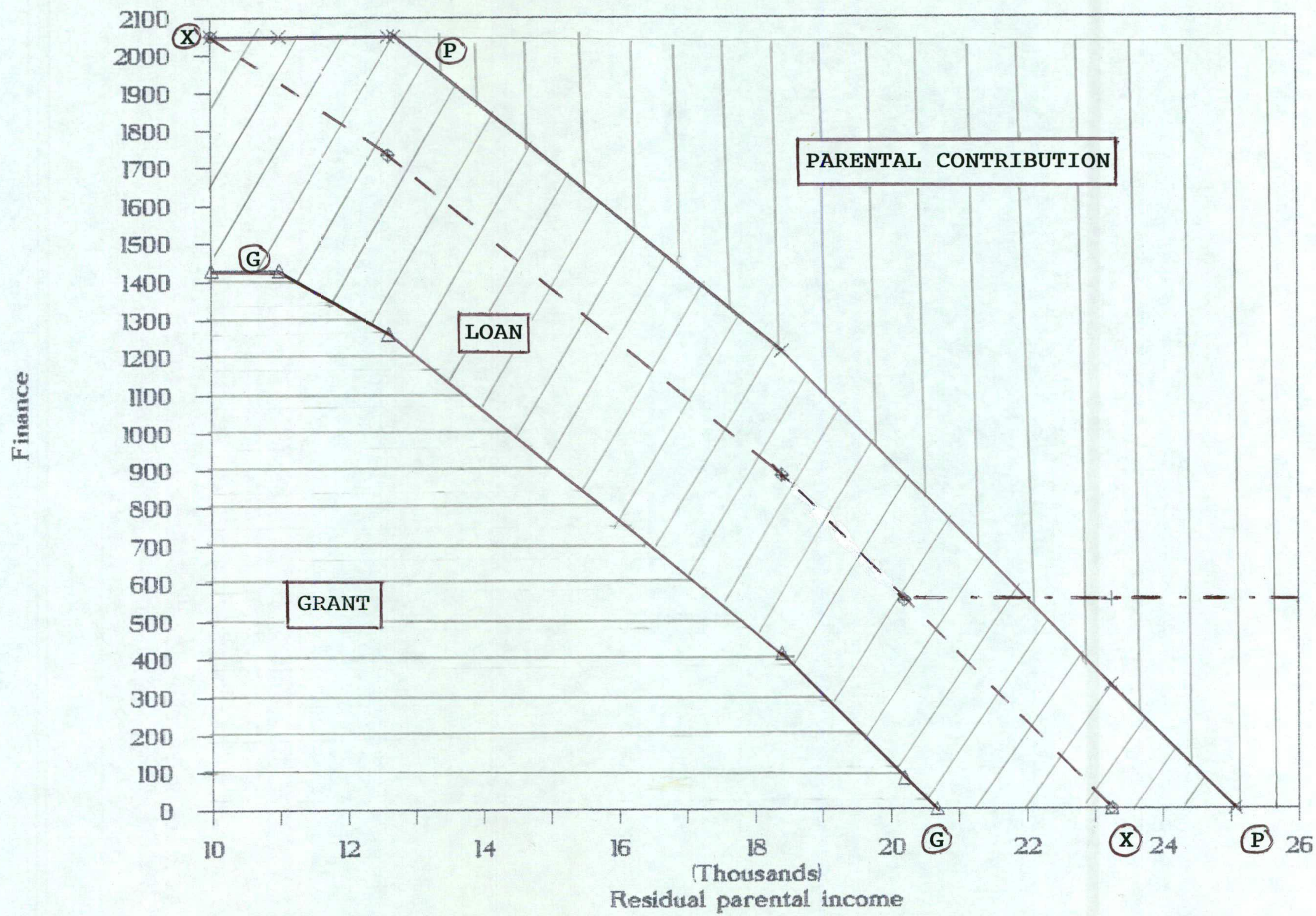


FIGURE 2

CONFIDENTIAL



FROM: S P JUDGE
28 January 1988

pmp.

APS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Sir Peter Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Cropper
Mr Tyrie
Mr Call

REVIEW OF STUDENT SUPPORT

I must apologise for a transcription error in the final column of the table in paragraph 3 of the Paymaster General's minute of yesterday: it has been pointed out to me that these figures do not add up.

2. The figure in the first row should read "385"; that in the fourth row should read "780". Sorry!

S P JUDGE
Private Secretary

052/3650

CONFIDENTIAL

~~papers~~ pse (on BF)

M BF 3/2

MW

Thanks. 2. PSO pl look over papers for any on this. –

FROM: A G TYRIE
DATE: 28 JANUARY 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Gilmore
Mr Burr
Mr Cropper
Mr Call

TYRIE TO CX 28 JAN

REVIEW OF STUDENT SUPPORT

You asked for views on Robert Jackson's paper.

I can save a good deal of paper by saying that I entirely agree with the Paymaster General's conclusions.

Robert Jackson wants:

- selectivity in the use of the grant element;
- the removal of the 'assessed' element of parental contributions;
- loans provided by private institutions.

That is attempting too much. Let's take advantage of the present climate (and the fact that on this occasion we even have a Manifesto pledge) to get something in place. Once we have even a very small scheme going we can build on it. At the very least future Governments would be able to expand this scheme by plowing back repaid loans.

One further point. I strongly suspect that Kenneth Baker has decided that there are few browny points in mucking around with student grants/loans. I expect his political judgement is right. But it also means that DES's enthusiasm for pushing something through is unlikely to reach boiling point.

AGT.

A G TYRIE

I note that there is, essentially only one key point — X (para 12(b)). What advice is the No 10 policy unit giving the PM on this? M.

978/8

CONFIDENTIAL

FROM: T J BURR
29 January 1988

PAYMASTER GENERAL

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Gilmore
Mr Bolt

Ch/CST is considering need for you to attend E(EP) in place of PMG. I understand you have expressed interest in this subject in past, so you may like to know this is an agenda. MPW 29/1

E(EP)(88)2: EDUCATION REFORM BILL: HIGHER EDUCATION PROVISIONS

I understand that the Chief Secretary is unable to attend E(EP) on 3 February, and that it is not yet decided whether the Chancellor will attend. I am addressing this brief to you now because it seems desirable to put it forward in good time, since the paper contains one rather awkward issue which Ministers will want to consider carefully. Separate briefing will follow on the other agenda items, including the proposed abolition of ILEA.

The paper

2. The paper considers how the Government should respond to the main criticisms which have been levelled at the higher education provisions of the Education Reform Bill. There are essentially three criticisms, which are that the Bill:

(a) gives the Government excessive powers over the new Universities Funding Council (UFC) and the universities themselves;

(b) denies the UFC the right to advise the Government on the financial needs of the universities;

(c) abolishes tenure without substituting an adequate safeguard for academic freedom.

Mr Baker proposes to do nothing about (c), but to rely on the argument that academic freedom has not in practice been threatened in the polytechnics, which do not have tenure, while expressing wilingness to raise with the Commissioners (who will be responsible for amending university statutes to remove tenure) any legitimate concern that the amended statutes give academics insufficient protection from discrimination. He proposes to put down amendments on (a) and (b), and these are dealt with in turn below. But the main issue for the Treasury arises on (b)

Powers of the Secretary of State

3. Under the Bill, both the Secretary of State and the two Funding Councils (the Polytechnics and Colleges Funding Council (PCFC) as well as the UFC) are empowered to attach conditions to their funding of institutions. The Secretary of State is also empowered to give directions to the Funding Councils. It is clearly in the Treasury's interest that these powers should be retained in the Bill in order, as Mr Baker says, to enable the Government to safeguard the taxpayers' interest in the large sums of money to be allocated by the Funding Councils. The criticism which has been made is that these powers could also enable the Government to discriminate between institutions and to interfere in their affairs. To meet this criticism, Mr Baker proposes the following amendments:

(i) neither the powers to attach conditions nor the power of direction should be used to affect the use of funds which an institution has not received from the UFC or PCFC;

(ii) the power of direction would be made subject to Negative Resolution;

(iii) the Secretary of State's powers to attach conditions would not permit discrimination between named institutions;

(iv) it would be made explicit that the Bill's provision whereby additional functions can be conferred on Funding Councils were limited to functions which the Secretary of State himself could exercise and which were consistent with the character and purpose of the Funding Councils;

(v) the provision for the Funding Councils to require repayment of funds if conditions of grant are not complied with would be dropped.

4. We see no objection to (i). (ii) will obviously complicate the use of the power of direction, and would be best avoided. Mr Baker should be pressed as to whether it is really necessary to limit the Government's freedom in this way. Having said that, however, a direction to a Funding Council would be a pretty rare event, and the purpose of the power is more to show that the Government ultimately has the last word than actually to be brought into regular use. So you need not insist on this point if Mr Baker judges this to be an essential concession. (iii) is acceptable. The only circumstances of interest to the Treasury in which the Government is likely to have a legitimate interest in discriminating between named institutions is where a particular institution is subject to serious financial mismanagement; but in those circumstances the Government could almost certainly rely on the voluntary cooperation of the Funding Councils, as in the recent case of University College Cardiff. The power of direction would still remain as a last resort. (iv) seems unexceptionable.

5. We do however recommend you to object firmly to (v). The power to attach conditions to funding is likely to become meaningless if the Funding Councils cannot require repayment of funds when the conditions are not fulfilled. It is not sufficient to say, as in the paper, that the same effect could be achieved by reducing future payments. That would not necessarily be so if the institution was getting into financial difficulty. Moreover it would be difficult to demonstrate clearly that the money had been recovered by this means, because it would seldom be entirely clear what the grant would otherwise have been, in the absence of recovery action. We think that the Accounting Officers of the Funding Councils need the protection of the power to require repayment.

Advice from the Funding Councils

6. This is the main issue, although one where we believe you

can on balance go along with what Mr Baker proposes. The paper records the agreement in H Committee that the UFC's terms of reference "should not include a specific standing invitation to the Council to advise on the total quantum of university funding". This conclusion reflected Treasury concern (shared we believe by the Prime Minister) that the Funding Councils should not publicly lobby the Government for increased expenditure on their respective sectors of higher education. DES subsequently made an attempt to re-open the matter at official level, but accepted that the Bill should say nothing about a right of advice on levels of funding. Arrangements for such advice would be left to be settled between the Secretary of State and the Funding Councils.

7. The Committee of Vice Chancellors and Principals have now put forward an amendment to the Bill, which has been put down by the Opposition, to the effect that the UFC should be

> "responsible for advising the Secretary of State on the needs of university education in the United Kingdom".

Mr Baker's difficulty in resisting this amendment is that it has never been the intention to exclude any advice from the Funding Councils about the overall level of funding in their sectors of higher education. That would not be sustainable, since they will have a closer knowledge of their respective sectors that the Secretary of State or his Department. Mr Baker has acknowledged all this, but is then left with no obvious answer to the question why he is unwilling to give the Funding Councils a right of advice in the Bill.

8. The real issue is at whose initiative the advice should come, and in what form. We have recognised that there would need to be a continuing dialogue between the Chairman and staff of the Funding Councils on the one hand and the Secretary of State and his Department on the other, in which the latter would gain a clear appreciation of the former's views on the appropriate level of funding. But it has been our objective that formal, and especially published advice should only be tendered when requested by the Secretary of State.

9. Mr Baker helpfully endorses the judgement in the Croham Report that an advisory body will not retain Government confidence, and its usefulness vanishes, if it acts as a stalking horse for special interests; and that it is for the universities themselves, not the Funding Councils, to put their case publicly if they wish to do so. But he believes that to offer no movement would be to invite defeat.

10. The amendment which he proposes would place a duty on the Funding Councils to advise on the needs of the institutions, but with the advice conveyed in a manner to be agreed with the Secretary of State. This should give control over the publication of such advice, and should thus meet the main Treasury concern. There are of course a number of dangers. If the advice were controversial or embarrassing it would be likely to leak. Moreover the qualification that the advice must be conveyed in a manner agreed with the Secretary of State is very vulnerable to being struck out by a further amendment during the passage of the Bill. It would have been much better to stand on the original position that only the executive role of the Funding Councils needed to be covered in legislation, not their advisory role. But we think it has to be accepted that this position is becoming untenable. If Mr Baker does not offer an amendment which expresses what he has accepted to be the Funding Council's advisory role, amendments will be forced on his which reflect other and less acceptable concepts of that role.

11. We have considered whether it would be best to hold back the amendment until the Bill reaches the Lords, where the pressures are likely to be greatest. But we think that it would be wrong to second guess Mr Baker's tactical judgement in handling the Bill. In any case the pressures are likely to grow if no concession is offered now, and by the time the Bill reaches the Lords there would be a risk that Mr Baker's proposal would be dismissed as inadequate. It is probably better to try to defuse the pressures now. But you will wish to emphasise that Mr Baker should do his utmost to avoid being pushed any further on this issue.

Recommendation

12. We therefore recommend that you should:

(a) question whether it is essential to accept that the power of direction to the Funding Councils should be subject to negative resolution, but not press the point if Mr Baker insists.

X (b) resist the proposal to drop the provision for the Funding Councils to require repayment of funds where conditions of grant are not complied with;

(c) agree to the proposed amendment on the right of advice, but emphasise the importance of not going any further.

T J Burr

T J BURR

ps2/56M

CONFIDENTIAL

PMP

FROM: MISS M P WALLACE
DATE: 1 February 1988

PS/PAYMASTER GENERAL

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Gilmore
Mr Burr
Mr Bolt

E(EP)2: EDUCATION REFORM BILL: HIGHER EDUCATION PROVISIONS

The Chancellor has seen Mr Burr's minute of 29 January. The Chancellor thinks that the key point is Mr Burr's 12(b) - retention of provision for the Funding Councils to require repayment of grant where its conditions have not been complied with. He would be interested to know how the No.10 Policy Unit is advising the Prime Minister on this.

MPW.

MOIRA WALLACE

001/4214

CONFIDENTIAL

FROM: **CHIEF SECRETARY**
DATE: **1 February 1988**

CHANCELLOR

I shd be grateful if PMG wd do this

cc: Paymaster General

E(EP) WEDNESDAY

You will recall that I am giving evidence to the TCSC on the PEWP on Wednesday and unfortunately I am unable to attend E(EP).

2 There are three papers on (a) Abolition of ILEA, (b) Higher Education Provision and (c) Charging for School Activities.

3 There are Treasury interests but none, I think, that would compel your attendance. Although I am reluctant to add to the Paymaster General's very considerable work load I think he would be admirably qualified to defend the Treasury wicket on this occasion. Moreover as a former Education Minister I suspect he is more likely to score a few boundaries than anyone else.

pp **JOHN MAJOR**

(Approved by the Chief Secretary + signed in his absence).

ps2/62M

CONFIDENTIAL

PMP

FROM: MISS M P WALLACE
DATE: 2 February 1988

PS/CHIEF SECRETARY

cc PS/Paymaster General
Mr Burr

E(EP) WEDNESDAY

The Chancellor was most grateful for the Chief Secretary's minute of 1 February. He would be very grateful if the Paymaster General would represent the Treasury interest on this occasion.

MPW.

MOIRA WALLACE

CHANCELLOR OF THE EXCHEQUER

pmg

STUDENT SUPPORT

Ch/

When you have finished your private word with Mr Baker I will bring the rest of the cast-list along from the Paymaster's room (x 5041)

MPW
15/2

1. ~~Julie~~ – to see. Burr knows. All OK
no action for you

2. B/f for meeting folder. 16/2

[redacted]

CHANCELLOR OF THE EXCHEQUER

OK. I will
have 10 mins with
Mr B alone 1st.
No official
support
req'd.
NL.

Ch/

We have now fixed
a meeting with Messrs
Baker and Jackson* –
an hour next Tuesday.
Do you want official
support? [And if so,
shall we move meeting from HoC
to No 11 – although
Mr Baker only has an
hour free and time will
be that much shorter.]

* and CST and PMG ✓

MPW
9/2

16/2

PMG

CHANCELLOR OF THE EXCHEQUER

Ch/

We are trying to fix up an internal meeting about student loans. Mr Baker has asked for a meeting with you in mid-to-late February. Could be a good opportunity to reinforce any points we have made in writing on Jackson scheme — and also for a chat about DES-implications of Budget. Shall we fix? Sooner rather than later? MPW 29/1

29140706. Lindsay.

Robert Jackson

U sec of State

979/007

CONFIDENTIAL

pmp

FROM: T J BURR
DATE: 3 February 1988

CHIEF SECRETARY

cc Chancellor Paymaster General
Financial Secretary
Sir P Middleton Economic Secretary
Mr Anson
Mr Kemp
Mr Gilmore
Mr Peretz
Mr Spackman
Mr Turnbull
Mr McIntyre
Miss Noble
Mr Richardson
Mr Bolt
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call

REVIEW OF STUDENT SUPPORT

Your minute of 26 January to the Chancellor on my submission of 14 January records that you asked us to cost options on the lines indicated in your minute. This note reports our preliminary results ahead of the Chancellor's meeting tomorrow.

BURR TO CST 3 FEB

2. The options which we have examined are as follows:

Option 1

Grant: frozen in cash for 5 years, then reduced to 50% of the current level by year 10;

Parental contribution: reduced by 5% a year for 10 years.

Option 2

Grant: initial cut of 20%, then progressively eliminated over 10 years;

Parental Contribution: initial cut of 20%, then eliminated over 10 years.

Option 3

Grant: as option 2;

Parental Contribution: as option 1.

All percentage reductions are in real terms. In all cases social security benefits for students would be replaced by loan, on a cost neutral basis, and the real reduction in grant and in parental contribution would be made up by loan. Other assumptions common to all options are set out in the Annex.

3. The net costs and savings (-) from these options are set out in the attached tables and summarised below. They are expressed in terms of PSBR effect because the DES costing model which we have used includes the effects of covenanting of the parental contribution, as well as public expenditure flows.

£ million

Year	1	5	10	15	20	Steady State
Option 1	-14	20	-19	-141	-233	-256
Option 2	-7	47	18	-167	-348	-445
Option 3	-18	-15	- 86	-263	-398	-446

We will be refining the figures to exclude covenanting and show the public expenditure effects (though these will not be markedly different), and also to show the effect of different take up assumptions (besides the 80% assumed here, which accounts for the savings in the first year).

4. The figures show the same broad pattern for the first two options. There is no major net effect during the first 10 years, although there are moderate costs before loan repayments start to flow in. Option 3 produces savings in all years, which are substantial by year 10. All options produce major savings in the longer term.

5. The attached tables also show the average debt for a student leaving a three year course. In summary the figures are as follows:

Year	1	5	10
Option 1	882	1806	3756
Option 2	1890	4086	6870
Option 3	1503	3327	5580

For option 1 and 2, the amounts are broadly constant over the range of parental income. For option 3 there is more variation, reflecting the fact that the reduction in grant is considerably sharper than in the parental contribution. (In effect, the loan element of support is means -tested on parental income.)

6 It should be borne in mind that reducing the parental contribution is not the only area in which there will be pressure to incur additional costs. DES are already pressing hard for social security benefits for students to be replaced by loan on a "levelling up", rather than a cost-neutral bais. No allowance is made for this in these costings. The amount involved could be as much as £50 million a year.

T J Burr

T J BURR

PS

We have now produced calculations for 100 per cent take up. These show the following picture:

Year	1	5	10	15	20	Steady State
Option 1	4	62	53	- 99	- 214	- 243
Option 2	18	143	158	- 73	- 300	- 420
Option 3	4	63	24	- 197	- 366	- 426

As might be expected, the financial effects are a good deal less favourable on this basis. It may be doubted take-up will in practice be as high as this but we cannot be sure.

[illegible] 8/5

Option I

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	(14)	20	(19)	(141)	(233)	(256)
Grant/sb/covenanting	(90)	(165)	(349)	(349)	(349)	(349)
Loan outlay	76	190	396	396	396	396
Loan repayments	0	4	66	188	280	303
Net PSBR	(14)	20	(19)	(141)	(233)	(256)

	Present Policy	New Policy year 1	year 5	year 10
Average net grant	£1,215	£1,179	1,043.0	£608
Average parental contribtution	£860	£817	645.0	£430
Average loan	n/a	£294	602.0	£1,252
Average debt for student leaving a 3 year course	n/a	£882	1,806.0	£3,756

Total number of students	395,000
Take-up rate for loans	80%
Default rate	10%
Real interest rate	0%
Repayment schedule	8 equal annual instalments beginning in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

Option II

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	(7)	47	18	(167)	(348)	(445)
Grant/sb/covenanting	(119)	(380)	(615)	(615)	(615)	(615)
Loan outlay	112	430	724	724	724	724
Loan repayments	0	4	91	276	457	554
Net PSBR	(7)	47	18	(167)	(348)	(445)

	Present Policy	New Policy year 1	year 5	year 10
Average net grant	£1,215	£972	536.0	£0
Average parental contribtution	£860	£688	392.0	£0
Average loan	n/a	£630	1,362.0	£2,290
Average debt for student leaving a 3 year course	n/a	£1,890	4,086.0	£6,870

Total number of students	395,000
Take-up rate for loans	80%
Default rate	10%
Real interest rate	0%
Repayment schedule	12 equal annual instalments beginning in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

Option III

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	(18)	(15)	(86)	(263)	(398)	(446)
Grant/sb/covenanting	(116)	(362)	(584)	(584)	(584)	(584)
Loan outlay	98	350	588	588	588	588
Loan repayments	0	4	90	266	401	450
Net PSBR	(18)	(15)	(86)	(263)	(398)	(446)

	Present Policy	New Policy year 1	year 5	year 10
Average net grant	£1,215	£972	536.0	£0
Average parental contribtution	£860	£817	645.0	£430
Average loan	n/a	£501	1,109.0	£1,860
Average debt for student leaving a 3 year course	n/a	£1,503	3,327.0	£5,580

Total number of students	395,000
Take-up rate for loans	80%
Default rate	10%
Real interest rate	0%
Repayment schedule	10 equal annual instalments beginning in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

ANNEX

COMMON ASSUMPTIONS

(i) Zero real interest rate.

(ii) Repayment begins in the fourth year after graduation with options for further deferment if earnings are exceptionally low.

(iii) Default rate of 10%.

(iv) Repayment in equal annual instalments of 8 years (option I), 12 years (option II), 10 years (option III).

(v) Take up rate for loans of 80%.

(vi) Covenanting for parental contributions retained.

(vii) Changes to grants, parental contributions and introduction of loans do not apply to students who are already in higher education with the exception of a loan of £215 per student to replace social security.

NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY AT 2.30PM ON THURSDAY 4 FEBRUARY

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Mr Anson
Mr Kemp
Mr Gilmore
Mr Peretz
Mr Burr
Miss Noble
Mr Richardson
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call

NOTE OF MTG 4/2

REVIEW OF STUDENT SUPPORT

The Chancellor thanked Ministers and Advisers for setting out their views in writing. There appeared to be a fair amount of common ground, but there was a divergence of views about the parental contribution. The Chief Secretary and Paymaster General felt that some reduction would be a desirable sweetener in the move to loans. But the Economic Secretary and Mr Call were against the state's substituting for parental finance. It was therefore a question of deciding how big the loan element of student support should be, and the extent to which it should reduce grant and parental contribution respectively.

2. The Chief Secretary said that to get a loan scheme off the ground was a great prize, but Mr Jackson's proposals were complex and unsaleable: progress would have to be at a more modest pace,

and he remained of the view that some reduction in parental contribution would be a desirable sweetener. He was grateful for the preliminary costings provided by Mr Burr: in his view option 2 was the most attractive. The Paymaster General said that he remained of the view that the student loan system could only be made saleable if the Government could head off criticism from the better off. The Financial Secretary concurred.

3. The Chancellor said that he thought the letter to Mr Baker ought to be kept short. It ought to stress the need for speedy progress, and point out clearly that a scheme as complex as Mr Jackson's could not be negotiated in the necessary time scale. Mr Burr's draft letter set out quite clearly why the Jackson scheme could not be regarded as genuine private finance. A simpler Treasury scheme would involve the banks only as agents who would have to tender for the contract just like everyone else. Mr Gilmore pointed out that the Treasury had made these points forcefully already, but Mr Jackson's proposal had so far been little moderated. The Chancellor said that he thought Mr Baker could be brought on side once he realised that (a) the sums envisaged by Mr Jackson simply were not available, and (b) a lengthy process of negotiations with the institutions would effectively rule out a move to loans this Parliament.

4. There was a brief discussion of the tactics to be adopted in the letter to Mr Baker. DES already had some idea of the kind of scheme that would find favour but as yet the Treasury had not indicated how much extra money it would be prepared to spend to get loans off the ground. Equally, the Treasury had not revealed a willingness to move on the parental contribution. It would be necessary to consider how much extra public expenditure Ministers were prepared to contemplate as a sweetener. The costings provided by Mr Burr showed a cost of £47 million in year for option 2, but this assumed take-up of 80 per cent, which might well be understated, and the costings were very sensitive to the assumption

in the early years.

5. Mr Kemp expressed the concern that any mention of a specific "acceptable price" would risk stimulating further bids from DES. The Chancellor said that for the moment the Treasury could simply say that it was prepared to consider some extra public expenditure in the short term, but that this was entirely contingent on delivery of workable proposals for switching grant into loan.

6. The Chancellor said that it might be useful to put to DES the suggestion that parental contribution and grant could be reduced exactly in parallel. It would follow that if DES wanted to eliminate parental contributions they would also have to eliminate grant. However, public statements about introduction of a loan system had always talked about loans topping up grants: this would constrain action for the present.

7. Sir P Middleton asked how the zero real rate of interest was to be calculated. It was agreed that it would be sensible to describe it rather as an interest free loan, with indexed capital. Sir P Middleton also said it would be important to consider the employment effects of introduction of loans: would people be locked into particular jobs if their employer was paying off their loan, and would the public services be able to compete with the private sector to recruit graduates of sufficient quality?

8. The Chancellor commented that the public services were already competing for graduates with employers offering very attractive salaries and extra perks. Introduction of loans would undoubtedly have some impact on choice of subject: but it was desirable that young people should take responsibility for the decision to go to university in the first place, and for their choice of subject. Detailed questions of, for example, possible special treatment for students undertaking long courses had not yet been considered by the Review Group. Time was being lost in considering a scheme that

was complex and unworkable. It was therefore important to reach agreement on the broad outlines of the way forward as soon as possible. It was agreed that HE would provide a revised draft letter for the Chancellor to send to Mr Baker.

MOIRA WALLACE
15 February 1988

Circulation: those present

SS 131/28/065

Ch/ 'X' below is, strictly, true. HE see no reason for you to comment on this. If you are content I will write a short letter to PS/Mr Baker to say that you have no comments.

JT 10/2

I am content

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

ELIZABETH HOUSE
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LONDON SE1 7PH
01-934 9000

CH/EXCHEQUER
REC. 05FEB1988
ACTION MR BURR
COPIES TO CST, SIR P. MIDDLETON, MR ANSON, MR KEMP, MR GILMORE

Jonathan Taylor Esq
Private Secretary to
the Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

OK

4 February 1988

Dear Jonathan

You will see from the attached correspondence that the Prime Minister and my Secretary of State have agreed in principle that there should be established a Committee of Inquiry into discipline in schools. The Secretary of State for Wales has asked that the Committee's remit should extend to Wales.

Neither the length of the inquiry, which shall be no longer than twelve months, nor its membership, which shall be no more than six or seven including the Chairman, have yet been agreed.

X/ I am advised that according to the Guide on Public Appointments Procedure, it is customary to inform the Chancellor of such proposals so that he may comment if he so wishes.

Yours

Chris de Grouchy

CHRIS DE GROUCHY
Private Secretary

MR STUART
MR W B W THOMPSON
MRS REISZ
MR WILKINSON
MR KERPEL

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

MRS A J[illegible]
INA ✓ 3/1

COPIES
MR JOHNSTONE
MS CASBON
MRS BAILEY
MR HALSEY

PRIME MINISTER

VIOLENCE IN SCHOOLS

The Professional Association of Teachers have written asking you to set up a Commission of Enquiry into discipline in schools, following a survey of their members which was reported in the Daily Express. Your Private Secretary recorded in his letter of 2 December that you were sympathetic to their request, but favoured a small committee of perhaps 3 people.

2. I welcome the proposal for an Enquiry and I have spoken to Brian Griffiths about the way in which it might best be conducted. I feel - and I think Brian agrees - that an Enquiry would be a way of demonstrating the Government's awareness of the problems which teachers now face in schools and our desire to help them. To increase the impact of that message I think it would be prudent to put one trade unionist on the Committee. The choice of individual will, of course, need to be considered with great care - but I would not wish to rule out Fred Smithies of the NAS/UWT at this stage. He would I believe behave responsibly given the nature of the enquiry.

3. Even more important would be the choice of chairman. One candidate is Lord Butterworth, formerly Vice-Chancellor of Warwick. Though 69, he is still very active. He is a qualified lawyer who has served on a wide range of committees. He is widely known and respected in education and would command confidence. I think he would be a stronger candidate than Sir John Butterfield, Master of Downing College, whose name has been suggested to you and whose background is medical.

4. For the rest, I share your preference for a small Enquiry team, but I see a good case for including serving head teachers of primary and secondary schools, a local authority administrator and a lay-person with knowledge of inner city problems as well as a trade unionist. That would point to a team of 6 people including the chairman.

5. The terms of reference should, I suggest, be broadly based and focus on the general problem of maintaining order in schools. While violent attacks on teachers are deplorable, they represent only part of the problem. I am equally concerned about less serious incidents of indiscipline, which nevertheless can have a damaging effect on the attainment of pupils. Our objective must be to try to help schools to create the conditions in which effective teaching and learning can take place. I therefore propose terms of reference on the following lines:-

> "to consider what action can be taken by central Government local authorities, voluntary bodies owning schools, boards of governors, head teachers and teachers themselves to

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secure the orderly atmosphere necessary in schools for effective teaching and learning to take place."

I would expect the Enquiry to report within 12 months.

6. Such an Enquiry would offer us a number of advantages. The fact of the announcement would be seen as showing concern and support for teachers. I hope that the Enquiry might recommend a model policy statement about behaviour in schools. Such a statement was recommended in a report by HM Inspectorate on the subject of discipline which we issued earlier this year - "Education Observed Number 5: Good Behaviour and Discipline in Schools". The Enquiry could also make recommendations on the role of the governing body, which we could promulgate in departmental guidance to governors. We would also look to it to produce advice on in-service training programmes for teachers.

7. I should welcome Peter Walker's views on whether the Enquiry should extend to Wales. I think that an extension to Scotland and Northern Ireland would be unhelpful given that their curricular and organisational arrangements are so different.

8. If you are content, I propose to aim for an announcement as soon as possible in the New Year. At the same time I plan to write to all head teachers announcing the Enquiry, explaining why I have decided to set it up and inviting them to send suggestions to the Enquiry. Pending the announcement of the Enquiry, your Private Secretary might write to the Professional Association of Teachers on the lines of the draft attached.

9. I am copying this minute to Peter Walker, Tom King and Malcolm Rifkind, who will want to comment on whether the Enquiry I propose should extend beyond England. Copies also go to Douglas Hurd, Brian Griffiths and Sir Robin Butler.

K.B.

KB

Department of Education and Science 31 December 1987

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DRAFT

P Dawson Esq OBE BSc
General Secretary
Professional Association of Teachers
99 Friar Gate
DERBY
DE1 1EZ

Letter for signature - Private Secretary to Prime Minister

The Prime Minister has asked me to thank you for your letter of 30 November informing her of the resolution passed by your executive committee calling on the Government to establish a commission of enquiry into discipline in schools.

The Prime Minister was interested to see the analysis of the returns to the Association's questionnaire, and recognises the concern which has been expressed by your members. She deplores any incidents of violence by pupils against teachers. She is still considering the Association's proposal for an enquiry, which raises a number of issues, but will send a full reply to your letter as soon as possible.

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153/1

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Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

12 January 1988

CT/3687/87

Dear Kenneth

Your officials have been in touch with mine about the suggestion by the Professional Association of Teachers that a Committee of Enquiry be established to consider matters of discipline in schools.

I too can see merit in agreeing to their proposal and would wish to press for the remit of any such Committee to extend to Wales. In this event, I can see considerable advantage in having a Welsh member and I shall give consideration to possible names.

Copies of this letter go to the Prime Minister, Tom King and Malcolm Rifkind.

Rt Hon Kenneth Baker MP
Secretary of State for Education and Science

DES
MR STUART
INFO ✓

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MR STUART

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LONDON SW1A 2AA

From the Private Secretary

20 January 1988

MR HALSEY
SCI
MR NBW THOMPSON
MRS REISZ

MR WILKINSON
MR WERPEL

Dear Chris

VIOLENCE IN SCHOOLS

The Prime Minister has seen your Secretary of State's minute of 31 December on violence in schools. She is pleased to see that he agrees that a Commission of Enquiry should be established, but has made a number of specific points. Firstly, she does not support the idea of placing one trade unionist on the Committee. Her view is that this seat should be taken by a practising teacher. She is also unsure that Lord Butterworth is indeed the most appropriate person to lead the enquiry and has asked that alternative names be considered.

With regard to the Terms of Reference she would like these to be drawn as tightly as possible and suggests that these might be revised as follows:

> "In view of public concern about violence and indiscipline in schools and the problems faced by the teaching profession today to consider what action can be taken by central Government local authorities, voluntary bodies owning schools, boards of governors, head teachers and teachers themselves to secure the orderly atmosphere necessary in schools for effective teaching and learning to take place."

Finally, the Prime Minister would hope that the Commission could report in substantially less than 12 months. She wishes to keep it as sharply focussed as possible and is concerned that it should not end up simply demanding more resources and extra research.

I am copying this letter to the Private Secretaries to the Secretaries of State for Wales, Northern Ireland and Scotland, the Home Secretary, Brian Griffiths and to Trevor Woolley (Cabinet Office).

Yours ever

Andy

P. A. BEARPARK

Chris de Grouchy, Esq.,
Department of Education and Science