

Balancing Access and Affordability: An Analysis of the UK's Student Loan Policy and the Implications of Plan 5

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Abstract: Student loans play a crucial role in enabling higher education access for students, significantly influencing their academic and financial futures, as the tuition and living cost continues to rise. This paper provides a comprehensive analysis on the UK's student loan policy, tracing its historical development and the challenges it faces. This study demonstrates the UK government's efforts to balance educational accessibility with economic viability, evaluating the impact of the newly introduced Plan 5 student loans in terms of its lower repayment threshold, extended repayment term, and interest rate cap. It finds that while Plan 5 may increase the proportion of loans repaid, potentially easing fiscal pressure, it also disproportionately affects moderate-income earners, who could face higher long-term financial obligations. The paper suggests innovative policy solutions, such as market-linked assistance and service-based repayment options, emphasizing the need for personalized loan terms. It calls for further research to ensure fiscal responsibility and student support, advocating for policies that balance government finances and student needs.

Keywords: student loans, fiscal sustainability, Plan 5.

1. Introduction

Higher education has long been regarded as a gateway to personal and social advancement. However, with the rising costs of tuition and living expenses, student loans have become a necessary financial support for many students. The UK government's commitment to providing loans reflects a dedication to equal opportunities; yet, the sustainability of this system and its impact on students' academic performance requires careful consideration. This paper focuses on analyzing the UK government's continuous effort on balancing educational accessibility with economic viability and evaluates the probable influence of the newly launched Plan 5 policy while providing some further policy recommendations.

The extant scholarly discourse predominantly centers on the ramifications of student loans for academic achievement, vocational pathways, future financial well-being, and psychological health of students [1, 2]. Also, there exists a spectrum of opinions regarding the efficacy and efficiency of student loan programs. A more significant role for student fee contributions and income-dependent loans in financing UK higher education is suggested [3]. The fairness of student financial support is in doubt and there is a trend of arguing for alternative comparative methods across the UK to foster more equitable higher education policies [4]. Comparatively less attention has been given to the fiscal implications of student loans for governments, with discussions centering on the factors influencing

student loan repayment and the rationality of student loan policies and systems. Student loan repayment is a critical issue that affects many individuals after completing their education. Several studies have explored various factors that influence student loan repayment behaviors. This includes that those with higher earnings were more inclined to meet standard loan repayments, whereas individuals with incomes below \$20,000 frequently encountered difficulties, underscoring the value of financial resources like savings and backing of the family [5]. The impact of financial socialization, knowledge, and education on student loan repayment practices are also examined, determining that those with financial education were less prone to delays in loan payments or anxiety about their debt [6]. Studies based on US student loan repayment indicates that increased access to credit corresponded with higher levels of borrowing. They also observed a notable rise in individuals carrying substantial loan balances [7, 8].

However, the default rate on loan repayments among UK graduates has remained high. The "Business, Innovation and Skills Committee" of the UK House of Commons has pointed out that there are significant problems with the student loan system, with the government losing 45 pence for every pound of student loans issued, meaning that 45% of the loan amount is unrecoverable, which is significantly higher than the initially estimated 28% by the government. Moreover, the report also mentions that with the increase in university tuition fees, it is projected that the total amount of student loans will reach a staggering £330 billion by 2044, undoubtedly putting immense financial pressure on the government. The rising student loan default rates can be attributed to several factors. The increasing cost of higher education has led to a greater demand for loans. Additionally, the uncertainty in the labor market has made it difficult for graduates to secure well-paying jobs, impacting their ability to repay loans. The inadequacy of current repayment plans, which do not sufficiently consider the fluctuating incomes of borrowers and the economic downturn, further exacerbated the situation [9]. In recent years, the British government, eager to reduce its fiscal deficit, has tried different methods to reform student loans that are slow to be recovered, of low benefits, and difficult to collect. Notably, the Plan 5 policy, introduced in the United Kingdom in September 2023, has not been extensively covered in scholarly articles, and even Wikipedia lacks updated information on this policy.

Given the increasingly constrained fiscal situation of the UK government, the provision of student loans necessitates not only efficacy but also sustainability. This paper aims to provide a comprehensive overview of the development and challenges of student loans in the UK. It analyzes the effectiveness of newly introduced policies aimed at improving and offering policy recommendations which innovatively associating student loan policy with market-linked assistance, service-based repayment options and emphasizing the importance of personalized loan terms.

2. Overview of Student Loan in the UK

2.1. The Student Loan System

The United Kingdom's student loan policy was a struggle for balance between the student's welfare and the national finance. The student's tuition and living cost were once completely covered and did not have to be repaid in the UK. The government further established the Student Loans Company (SLC) to provide living costs loans with low-interest. In 1998, the cost was too high for the government to fully afford and students were asked to contribute in their tuition fee. The student funding model tied to household income was thus formed, which first introduced the tuition fees and the repayable student loans. The main idea is repaying a certain amount of one's salary once the salary meets a threshold and if the repayment is not complete after a fixed amount of years, the loans will be written off. The tuition fees kept rising in the following years and raised a huge scale of loan. The amount of repayment could not meet the expectation.

The most familiar policy is the “Plan 2” loan for students who started their courses between 2012 and 2022. It mandates repayments once graduates exceed an income threshold, currently £27,295, and pay 9% of their income above this level. The interest on these loans can be as high as Retail Price Index (RPI) plus 3%, but varies based on income. After 30 years, any remaining debt is forgiven.

2.2. Burden on Public Finance

Despite repeated adjusting efforts made by the government, student loans have increasingly become a financial burden for the public finance. The growth in student loans has been remarkable, with the number and value of loans and take-up increasing substantially over the years. The SLC statistics show that the yearly loan acquisition has seen a dramatic increase, soaring from 180,000 instances in 1990 to 1991 to 1,223,000 in 2022 to 2023. Concurrently, the average loan value has also witnessed an uptick, rising from £390 to £14,560 across the same period, reflecting the escalating costs of higher education. The total loan sums extended have seen a significant leap, escalating from £70 million to £17,798 million, which underscore the substantial financial commitment required to support students' educational pursuits. SLC statistics also indicate the rising debt levels of student loans year by year, with the total debt reaching £236.2 billion by the end of the 2023 to 2024 financial year. The forecast predicts that the peak of outstanding debt will exceed £500 billion in the late 2040s, measured in 2023 to 2024 prices.

To alleviate this burden, the UK government once purposed a sale of student loans in February of 2017, also to alleviate fiscal pressures. They announced the sale of £4 billion in loans made between 2002 and 2006 to private entities. Despite assurances that loan terms would not change, the sale had been criticized as economically shortsighted and ethically dubious. Similar purpose also happened in Australia and Hong Kong, but the matter was dropped because of public criticism.

3. Current Policy Solution

3.1. Plan 5 Student Loans

In 2022, the government announced important changes, that for students starting university from the 2023 academic year would be eligible for “Plan 5” student loans. The introduction of Plan 5 in the UK is aimed at addressing several key issues within the student loan system. According to the government publication “Student loan forecasts for England, Financial year 2022 to 2023”, Plan 5 was implemented to reform the repayment terms of student loans, enhancing the sustainability and fairness of the system. It features a lower repayment threshold compared to Plan 2, which means that repayments begin at an income level of £25,000, as opposed to £27,295 under the previous plan. This change is expected to capture a broader segment of the working population for loan repayments. Additionally, Plan 5 extends the maximum repayment term from 30 to 40 years. Another significant aspect of Plan 5 is the interest rate cap set at the RPI, which is more favorable than the RPI plus 3% rate during study and the variable rate after study under Plan 2. This lower interest rate is expected to reduce the overall debt burden on borrowers. The new plan also takes into account the varying lifetime earnings of borrowers, with the expectation that higher earners will repay more than lower earners, aligning with the principle of progressive contribution to the cost of higher education. Plan 5, designed for students commencing their studies from the 2023 to 2024 academic year, presents a mixed impact on government finances and individual borrowers.

3.2. Policy Analysis

From the government's perspective, the plan is anticipated to alleviate the fiscal burden by aligning loan interest rates with inflation and extending the repayment term to 40 years. However, while the

government anticipates that around 65% of full-time undergraduates starting in 2023 to 2024 will fully repay their loans, this figure is more than double the forecast for the 2022 to 2023 cohort, which stands at 27%. This disparity underscores the difficulty in achieving the desired fiscal balance through student loan repayments.

From the student's perspective, it is said that the lower repayment threshold and extended repayment period under Plan 5 could lessen the immediate financial burden on graduates. Also, students may benefit from the predictability of an inflation-linked interest rate, providing more certainty in their repayment planning. In contrast to the 2022 to 2023 academic year group, those from 2023 to 2024 are anticipated not to repay significantly more than the principal in real terms, primarily due to the inflation-tied interest on Plan 5 loans. Presently, top earners who settle their loans entirely might end up paying slightly above the borrowed amount in real terms, as the interest is projected to be determined by a delayed inflation figure, potentially mismatched with the current year's inflation.

However, there are also possibilities that the updated student loan framework could lead to individuals continuing repayments until their sixties. The revised plan may increase the financial burden on many graduates, with many paying over 50% more in comparison to the previous system, and a few even seeing their repayments double. Within the 2023 to 2024 cohort, those with lower incomes are anticipated to have higher lifetime repayments than their 2022 to 2023 counterparts, due to the lowered repayment thresholds and extended loan terms. Meanwhile, the highest income earners in the 2023 to 2024 cohort are expected to repay less than those in the 2022 to 2023 cohort, as they will face reduced interest due to lower rates and thresholds, allowing for quicker loan settlement. Although the new system eliminates the additional interest on student loans beyond the RPI rate, it primarily advantages higher earners who might pay more but over a shorter duration. In contrast, lower-to-middle earners may end up with increased repayments spread over a longer timeframe through smaller, ongoing installments.

The recent implementation of Plan 5 marks a significant shift in the UK's student loan landscape, yet the long-term and intricate nature of student loans makes it challenging to immediately predict the ultimate outcomes of the policy. An effective student loan policy should strive for a balance that considers both the government's fiscal health and the students' financial capacity. Globally, a search for improved solutions reveals that many countries are confronting challenges similar to those of the UK's student loan policies [10]. According to data released by the White House, 45 million Americans are carrying federal student loans, with over \$1.6 trillion in student loan debt outstanding; based on the latest figures from the Australian Taxation Office (ATO), approximately 2.95 million Australians are in debt under the Higher Education Loan Program (HELP), with the total amount of unpaid debt exceeding 78 billion Australian dollars. Even as debt continues to rise, governments may still need to prioritize the forgiveness of some debts to alleviate the cost of living pressures on people. Thus, finding appropriate policy solutions may require thinking outside the box.

The idea of selling student loans, as mentioned earlier, has inspired the notion of linking student assistance to market mechanisms. In the UK, undergraduates have access to a limited number of scholarships, with some being restricted to international students from specific countries or those pursuing particular courses. While universities offer scholarships, they too face significant financial pressures. Perhaps the corporate social responsibility (CSR) sector could be mobilized to establish scholarships for students in need. This approach would not only promote a positive public image for businesses but also extend an olive branch to future talents within higher education institutions. Compared to the politically sensitive issue of selling student loans, commercial scholarships are likely to face less public scrutiny. By engaging the private sector in education funding, a more sustainable and less contentious approach can be fostered to support students' financial needs.

Furthermore, in addition to on-campus work-study positions, recent graduates facing financial difficulties could be encouraged to consider enrollment in the military or performing public service roles that already receive government benefits as a means to offset a portion of their tuition fees. This approach aligns with the concept of service-based repayment options, which could provide both financial relief and valuable workforce development opportunities in sectors that are important to society. China's student loan policy offers the struggling students many options to work in specific job positions for a few years to offset a portion of their loan repayments. By integrating such initiatives into the UK's student loan strategy, a more holistic system that supports students' educational and professional journeys while also addressing the broader fiscal implications of student lending can be created.

An ideal loan agreement would not necessarily feature a uniform earnings limit beneath which no repayments are required from all borrowers, nor would it be defined by a static repayment percentage based on income exceeding this limit. In fact, the most effective loan terms might include supplementary financial support for those borrowers facing the most adverse consequences following their education. More refined and personalized repayment plans may also better address this issue, which requires further research and calculation [9].

4. Conclusion

In conclusion, this paper commenced with an overview of the UK's student loan system, tracing its evolution from a state-funded model to the current income-contingent repayment schemes. The introduction of 'Plan 5' in 2023 marked a significant policy change, aiming to address the sustainability and fairness of the student loan system. Plan 5 features a lower repayment threshold, an extended repayment term, and a capped interest rate linked to the RPI. These changes are expected to impact the fiscal balance, potentially increasing the proportion of loans repaid, which could alleviate some fiscal pressure on the government. However, the paper also identified potential drawbacks of Plan 5. The lower repayment threshold and extended repayment period may disproportionately affect moderate-income earners, who could face higher long-term financial obligations. This shift in financial responsibility raises concerns about the equitable distribution of costs and the potential impact on students' long-term financial well-being. The paper contributes to the discourse by casting doubt on the balance between income-contingent repayment models and the fiscal sustainability of such schemes. The paper also suggests exploring market-linked assistance and service-based repayment options, while emphasizing the need for personalized loan terms and further research to ensure fiscal responsibility and student support. More innovative, sustainable policies that balance government finances and student needs are required to address the deep-rooted problem.

However, the study acknowledges its limitations, primarily the reliance on the early stages of Plan 5's implementation. To fully assess the policy's effectiveness, long-term tracking is required, including interviews and surveys that provide a quantitative analysis of the policy's impact over time. Future research should compare the efficiency of Plan 5 with previous loan plans, considering factors such as repayment rates, loan write-offs, and the overall financial burden on borrowers. Additionally, future studies could benefit from a broader scope, incorporating international comparisons to contextualize the UK's approach within a global framework of student loan systems.

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