House of Commons

Business, Innovation and Skills Committee

Student Loans: Government Response to the Committee's Third Report of Session 2014–15

Second Special Report of Session 2014–15

Ordered by the House of Commons to be printed 4 November 2014

HC 777
Published on 6 November 2014
by authority of the House of Commons
London: The Stationery Office Limited
£5.00

Business, Innovation and Skills Committee

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The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk.

Publications

Committee reports are published on the Committee's website at www.parliament.uk/bis and by The Stationary Office by Order of the House.

Committee staff

The current staff of the Committee are James Davies (Clerk), Jessica Montgomery (Second Clerk), Peter Stam (Committee Specialist), Josephine Willows (Committee Specialist), Sonia Draper (Senior Committee Assistant), and Pam Morris (Committee Assistant).

Second Special Report

The Committee published its Third report of Session 2014-15, *Student Loans*, on 22 July 2014. The Government's response was received on 28 October 2014 and is appended to this report.

Appendix: Government response

Introduction

The Government welcomes the opportunity to address the issues raised in this constructive report. The wide ranging and substantial number of recommendations have been considered very carefully.

The Government's Higher Education reforms, following Lord Browne's independent review of higher education funding and student finance, have delivered a fundamental shift in the balance of funding, between state and student. The Government has developed a system that maintains the principle that higher education is free at the point of entry but ensures a flow of funding to institutions to sustain high quality learning. The Coalition is committed to delivering a university sector that is more responsive to the needs of students; which can continue to compete internationally and which is based on a progressive graduate contribution system.

Young people have not been deterred from Higher Education as a result of increased tuition fees. Access is based on ability to learn rather than ability to pay. Students continue to recognise the lifelong value of higher education. In 2014/15 higher education application rates for 18 year olds are at an all-time high, as are applications from disadvantaged students. In further developing the student loan system the Government has taken into account some of the Committee's recommendations and those from the National Audit Office (NAO) Student Loans Repayments Report from November 2013 and will continually improve the modelling and forecasting for student loans. Our reforms are fair for students, fair for borrowers and affordable for the nation.

Recommendations and Conclusions

Forecasting implications of the RAB charge

Recommendation 1: The evidence that we have received, both in this inquiry and previous inquiries, suggests that there has been a persistent miscalculation of the Department's estimates of the RAB charge. The resulting holes in the budget are only just beginning to materialise. Forecasters, particularly HEPI, had and continue to have a more accurate picture of repayments. Despite this, the Department has ignored their concerns. We recommend that, as a matter of urgency, the Department conducts a full review of all the financial assumptions underpinning the Department's RAB model. (Paragraph 17)

As a result of the recommendations of the Committee and the National Audit Office, we have updated the model for student loan repayments and the new model has been reviewed both internally and by the NAO as part of the process for producing the BIS accounts. We have taken the concerns of the sector into account when producing these new models. Forecasters such as the IFS have conducted independent analysis and produced results that are broadly in line with those of the Department. In order to make the process more transparent, we have published a simplified version of the new loan repayment model on the GOV.UK website.

Budgetary implications of the RAB charge

Recommendation 2: We support the Chief Secretary to the Treasury's ambition of improving the incentives for managing the long term costs of new student loans, and encourage the Treasury to look for further ways to strengthen these incentives. However, we are concerned that the current arrangements may have an adverse impact on unrelated BIS budgets in the medium term. (Paragraph 21)

The Government's reforms have enabled a fundamental shift, by ensuring the funding of higher education is a shared endeavour between state and student. There is more funding flowing into the higher education sector and this is enabling universities to remain world class and provide a better student experience. The Resource Accounting and Budgeting (RAB) charge is the estimated cost to Government of borrowing to support the student finance system based on future loan write-offs and interest subsidies in net present value terms. For convenience, we express these costs in percentage terms as proportion of the initial loan outlay. The RAB charge is calculated by taking repayment forecasts and discounting them back to the period that the loan is issued using the discount rate provided by Treasury (RPI+2.2%). This gives us a net present value (NPV) of the future repayments and the cost is the difference between the loan issued and the NPV of the repayments. We are working with an estimate of the cost of borrowing to Government which we currently expect to be around 45%. It is important to recognise that any estimate of the RAB charge is likely to fluctuate as it is highly dependent on macroeconomic circumstances and the growth of graduate earnings over the next 30 or so years in particular. Estimates can and will continue to change. There is no immediate pressure on the system.

Authority to distribute resources within each voted budgetary limit in the Parliamentary Supply Estimates is delegated by Treasury to BIS subject to specific rules set out in Treasury guidance. The Departmental Board and Sub-Committees will set departmental priorities and approve any budget transfers accordingly. All departments' budget provision beyond 2015-2016 will be agreed as part of the next Spending Review.

The Department for Business Innovation and Skills (BIS) is placing increased emphasis on the management of repayments though the creation of a Repayment Strategy Group and working with the Student Loans Company (SLC) and Her Majesty's Revenue and Customs (HMRC) in agreeing a Joint Repayment Strategy. This will further target losses and focus on performance improvement to maximise repayment yield and improve efficiencies

Recommendation 3: In order to improve transparency and accountability, we recommend that the Department publishes HM Treasury's targets for impairments for student loans alongside reports against actual performance. (Paragraph 22)

We accept the recommendation of the Committee that we should endeavour to be as transparent and accountable as possible when reporting on BIS budgets.

The department will continue to report the impact of loan impairments across DEL (Departmental Expenditure Limit) and AME (Annually Managed Expenditure) budgets in the Departmental Annual Report and Accounts, in accordance with the Chief Secretary of the Treasury's requirements. The Treasury target provides a baseline for the Department to measure student loan costs. The DEL budget impact of these changes was considered immaterial for reporting purposes in 2013-14 but will be kept under review to ensure transparency and accountability purposes.

Monitoring and reporting of the Student Loans Company against targets

Recommendation 4: For the NAO to conclude that the targets set for the Student Loans Company by the Department may have been misleading is a damning finding. It is obvious to us that the Department must address this as a matter of urgency. (Paragraph 26)

We accept that the targets could be improved. BIS has already taken on board both National Audit Office (NAO) and Public Accounts Committee (PAC) comments and, working with Student Loans Company (SLC), has reviewed and revised SLC's targets as part of the Company's Annual Performance and Resource Agreement (APRA), and Memorandum of Understanding (MOU). New targets have been set for 2014/15 to make them more specific, and we are working on targets for 2015-16. New metrics for 2015/16 are under development.

Targeting repayments

Recommendation 5: The NAO has highlighted under-performance in terms of the collection of loans and the need for an annual target of money collected in a year together with an explanation of any variance. We support that recommendation and look to the Department to set clear targets for the SLC as a matter of urgency and to publish the earnings and collection assumptions behind those targets. (Paragraph 30)

Accepted in part. We agree with the NAO and the Committee that it would be helpful to publish further information about the collection of student loans.

BIS will in future publish clear and easily understood annual forecasts of the amounts it expects to collect along with data on the actual amounts collected. The Department will explain any variances between the forecasts and the actual amounts collected. It is important to note that it is not possible to set *targets* for annual cash collection because student loan repayments are contingent on borrower income (which varies in line with the economy) and collection is through the taxation system at 9% over the repayment threshold. Therefore the SLC is unable to influence repayment amounts. However both the Government and the SLC are actively working to identify solutions to improve collection rates where borrowers are identified who should be repaying their debt, but aren't.

Borrowers now living overseas

Recommendation 6: The Government is finding it harder to collect from debtors who have moved abroad and the complicated structure of income-contingent loans adds to that difficulty. We therefore recommend that the Government assesses whether converting income contingent debt to mortgage-style debt for borrowers leaving the country would aid collection of outstanding student loans. (Paragraph 41)

The current process for borrowers who have moved overseas already has a number of features in common with the Mortgage-style arrangement;

- Borrowers repay debt directly to SLC rather than through the tax system.
- Borrowers only repay once their earnings reach a specified threshold.
- Repayments are made monthly to spread the collection over time.

The system of collection reflects relative differences in incomes and costs of living in different countries. When a borrower notifies the SLC that they are moving overseas their income is assessed against the repayment threshold for the country that they will be working in. A system of banded thresholds is used for borrowers who move overseas, using price level indices calculated by the World Bank, and updated annually. This takes account of the level of affordability in different countries and means that repayment will remain based on ability to pay, wherever the borrower lives. These arrangements are necessary to ensure that borrowers are treated equitably regardless of where they reside.

Debt recovery only becomes difficult when borrowers move overseas without either informing the SLC or establishing a repayment schedule. The introduction of a fully-fledged mortgage style system for those moving overseas would not make it easier to recover loans if the borrower actively evades entering repayment arrangements. We are investigating options to make repayment even easier for those overseas, and have funded a pilot project to extend the use of Debt Collection processes overseas for those seeking to evade their responsibility. If this pilot is deemed successful, and cost effective, then BIS will consider allocating additional resources needed to roll out wider debt collection processes. We are also in discussion with several countries to develop mutual processes for identifying overseas nationals who are not making the Higher Education loan repayments which are due. This is further covered under recommendation 8.

Absence of information

Recommendation 7: It is clear from our evidence and that of the Committee of Public Accounts that the overall approach to collecting student debt lacks rigour. It is the case that the SLC is required to meet targets set by the Department and it is true that the SLC has met most of these targets. However, we conclude that the SLC's targets are not fit for purpose and need urgent review. (Paragraph 46)

A new Repayment Strategy Sub-Group has been set up, with membership from BIS, the SLC, Her Majesty's Revenue and Customs and the Devolved Administrations to draw up and oversee a Joint Repayment Strategy. This group will take action to ensure the Department meets the NAO/PAC recommendations, as well as improve overall coordination of loan repayment activity.

International comparisons

Recommendation 8: It is regrettable that the Government did not do more to learn from examples of best practice overseas. The Government should examine examples of good practice overseas, including in the United States of America, in order to assess whether elements could be incorporated into the working culture of the SLC. (Paragraph 50)

It appears that all countries with student loan systems face similar problems, and none has completely solved the problem of borrowers moving overseas and, as a result, avoiding repayment of their loan. Over 80% of borrowers known to be overseas are either repaying, or their income is below the relevant repayment threshold. This shows that the SLC overseas collection system is working well. That said, we are working hard to strengthen our arrangements.

The majority of borrowers who are overseas are UK nationals. They are free to move overseas and we cannot predict who might do so. There is a clear statement in the student loan declaration which students sign when applying for a student loan. It says

> I acknowledge and agree that any loan(s) made to me by the Secretary of State for Business Innovation and Skills, "the lender" (which includes any persons exercising functions on behalf of the Secretary of State pursuant to section 23(4) of the Teaching and Higher Education Act 1998 as amended from time to time or successor legislation, "the Act") will be on the terms set out in these declarations and in Regulations which are made under section 22 of the Act as amended from time to time.
>
> The booklet—A Guide to Terms and Conditions sets out that where borrowers evade their repayments, SLC have the right to take legal action to recover the debt. This means SLC can get a court order to make the borrower repay the total plus interest and penalties in a single payment. This can be enforced through the courts as a civil debt whether you're in the UK or living abroad and the full costs can be passed to the borrower.

EU borrowers are more likely to move overseas, so SLC takes targeted action to set up repayment schedules for this group before they leave the UK. SLC does this by contacting all EU borrowers before they graduate to ensure they have correct contact details post-graduation and to remind them of their repayment responsibilities and the process at the cessation of their studies. We are consistently looking for opportunities to learn from other Higher Education loan systems overseas and have endeavoured to ensure that we have engaged with countries with similar systems to our own. Most recently, BIS has had meetings with officials from New Zealand in 2013 and 2014, and with officials from

Australia in 2014 to discuss how their student loan schemes operate and what lessons can be learned. We have agreed to work together in the future for mutual benefit.

We, together with the SLC, have held discussions with a number of EU countries to compare schemes. As a result of these discussions we have found that all those with comparable loan systems are wrestling with the issue of errant borrowers who move overseas and seek to evade repayment. A pilot project is being considered with two EU countries to share reciprocal data on borrowers who have moved overseas and a separate discussion is being held to have a similar agreement with Australia.

Whilst we lack statistics on the American system, it appears that USA has a similar problem with borrowers moving overseas and not repaying their student loan. However, the US system is very different to the UK and other EU loan systems so our current priority will be to further maximise repayments. We are working with behavioural analysts to see what more can be done to improve this communication.

Removing the cap on the numbers of students

Recommendation 9: The arrangements for the efficient collection of the student loan scheme are not working and the current system of 'debt' and 'repayment' is not being managed effectively. It is clear that an overhaul of the system is needed, especially in light of the Minister's assessment that the level of student debt will increase to approximately £330 billion by 2044. (Paragraph 54)

We disagree with the suggestion that the current system is not working.

We have designed a student support system which has at its heart, income contingent loan repayments. It is an important and deliberate part of the system that only those borrowers who go on to well-paid jobs will repay their loan or repay in full. There are no current plans to initiate changes to the income contingent student loan system in England. The changes that have been made to the student loan system since 2012 have made it more sustainable whilst increasing the amount of teaching capital that universities receive and maintaining the principle of access on ability to learn, rather than ability to pay.

We will of course continue to monitor the system in relation to Government affordability.

Recommendation 10: The Student Loans Company should be fair but robust in fulfilling its duty to achieve value for money and must demonstrate a strategic shift to a more dynamic culture in its duties to achieve the best value for the taxpayer through the most efficient collection of repayments. The Department should assist with this by realigning the formal targets to demonstrate this expectation and drive through a change of culture. (Paragraph 55)

We accept the spirit of the Committee's challenge that the direction of travel set out in the joint BIS/SLC Annual Performance and Resource Agreement (APRA), and Memorandum of Understanding (MOU) may need review to invest in and maximise repayment yield. Work is already underway to ensure that the Partnership is able to work more dynamically on this front.

We agree that a strategic shift is required to improve collection rates and work is already underway. BIS, SLC, HMRC and the Devolved Administrations are working together to develop a joint approach to drive efficiency gains, increased recovery of debt and improved borrower satisfaction.

The SLC's 'Transformation Programme' will replace outdated technology and fundamentally improve on how BIS and SLC delivers better products and services to its customers. SLC have refreshed their Repayment Strategy and are in the process of appointing a new Executive Director responsible for repayment and fraud. The objective of the revised strategy is to collect every pound due. This focuses on maximising repayment yield, but also includes goals for an improved customer experience and achieving internal SLC efficiencies. The strategy covers the 3 year period 2014-15 to 2016-17.

The Joint Repayment Strategy, linking BIS, Devolved Administrations, HMRC and SLC activity, includes an objective to develop improved targets for whole system performance.

Recommendation 11: The United Kingdom is approaching a tipping point for the financial viability of the student loans system and the removal of the cap on student numbers will put even greater pressure on the system. There is a need for an urgent review of the sustainability of the system. We recommend that, in its response to this Report, the Government must come back with a clear timescale for this review. (Paragraph 56)

Lord Browne's Independent Review into Higher Education Funding and Student Support published in October 2010 recommended an increase of tuition fees for higher education to ensure the system had a sufficient stream of income to maintain quality and remain internationally competitive. A White Paper 'Students at the Heart of the System' published in June 2011 set the framework for higher education policy in England. Our universities are now well-funded and this is driving up the quality of the student experience and helping to stimulate economic growth.

The Government has no current plans to initiate a formal review of the sustainability of the student loans system in England. Indeed the OECD's Director for Education and Skills, Andreas Schleicher, considers that we are the first European country to have established a sustainable higher education system.

The Government is committed to supporting the growth of high quality HE provision in England, ensuring it remains free at the point of access. The costs of the loan system are based on projections of graduate repayments over the next 35 years. These projections were revised in 2013-14 following changes to the student loan repayments model, but will continue to fluctuate due to numerous macroeconomic variables, and present no immediate pressure on the system. This is a long term investment in the skills of the nation. The new loans system has enabled us to give more income to HEIs to boost quality of provision during a period of austerity. What is of key importance is that we have protected our world class higher education system and we have not deterred students from participating in HE. The application rate for all English 18 year olds has increased in 2014 to the highest ever level (34.8%) and there are a higher proportion of disadvantaged pupils applying to university than ever before (20.7%). This means that 18 year olds living in the most disadvantaged areas in England are nearly twice as likely to apply than they were 10 years ago: 10.7% in 2004 to 20.7% in 2014. We will of course be interested in the work of the various reviews of higher education funding including the Universities UK (UUK) Student Funding panel.

Historical sale of the mortgage-style loan-book

Recommendation 12: It is clear that the private sector can see a profit in collecting student loan debts that the Government cannot. These findings reinforce our previous conclusions on the performance of the SLC's debt collection. It also lends weight to the Minister's ambition for the Student Loans Company to be removed from this aspect of the student loan system for mortgage-style loans which may be extended to the income contingent loans. (Paragraph 64)

Recommendation 13: We recommend that the Department outlines what rate of repayment it was achieving on the £890 million of mortgage-style loans which have now been sold. This may then be used as a benchmark to consider the future sales of income contingent loans. We further recommend that the Minister sets out the minimum level of performance he expects of the SLC in pursuing the income-contingent loans before he would consider moving all debt collection to the private sector. (Paragraph 65)

The sale of the remaining publicly owned mortgage style student loans in November 2013 achieved good value for money. By transferring ownership of the student loans, to the private sector—including their administration and collection—the SLC has been able to focus on supplying loans to current students and collecting repayments on newer (income contingent) loans. The SLC makes repayment data publicly available via its Statistical First Releases. The published repayment rate (UK wide) for the remaining publicly owned mortgage style student loans sold in November 2013 in the three years prior to sale was £80.2m (2010/11), £67.1m (2011/12) and £50m (2012/13).

The mortgage style student loan portfolio was materially different to the ICR student loan portfolio – not only with regard to the terms and conditions of the loans, but also to the collection mechanism. Whilst SLC collected mortgage style student loan repayments, the large majority of ICR student loan repayments are now collected via HMRC. SLC only collects repayments on loans made to overseas borrowers, and administers early repayments. It would therefore not be appropriate to use the benchmark suggested. There is also no plan to transfer administration and collection of the ICR student loans to the private sector as the tax system is acknowledged as an efficient and cost effective collection mechanism. The Joint Repayment Strategy being developed by BIS, Devolved Administrations, HMRC and SLC will, over time, lead to overall improvements in collection rates.

Terms and conditions

Recommendation 14: The Minister has been clear in his public statements that the Department would not change any of the terms and conditions attached to the loans as a

result of any sale. While it is the case that Ministers will retain the power to change the terms and conditions, this is not a new provision. We recommend that there should be no change in the terms and conditions of existing student loans without parliamentary approval. (Paragraph 69)

This is a deregulatory Government. Legislation is already in place and Parliament has oversight of any changes that Ministers plan to make through regulations to terms and conditions under Section 22 of the 1998 Act and we do not see the need for unnecessary legislation.

The interest rates for loans are changed annually, as set out in the relevant loan regulations and apply equally to sold and unsold loans. These annual changes are part of the loan conditions as set out in the student loan agreement and do not constitute an alteration of the loan terms.

Proposed sale of the income-contingent loan-book

Recommendation 15: The Government appears to have committed itself to the sale of the income contingent loans before it has fully assessed the financial viability of such a move. Demand for these assets is untested and without the introduction of a synthetic hedge would only realise around £2 billion of the £12 billion return expected by Government. While demand would increase with the introduction of a synthetic hedge, this would come with an additional long-term cost to Government, which has yet to be quantified. (Paragraph 78)

We have conducted detailed feasibility work on proposals for sales of pre-2012 income contingent student loans which suggests that sales have the potential to realise value for the taxpayer. However, as confirmed in the 2013 Autumn Statement, the proposed sales of Government assets, including pre-2012 income contingent student loans, will be subject to value for money assessments and this is an explicit objective of any future sale.

The estimated £2bn worth of value that a sale would achieve if the Government did not provide investors with protection from the interest cap (via the mechanism of a 'synthetic hedge') was based on market feedback from 2011. Views of the economy and future interest rates were considerably different and we therefore do not believe these views reflect current market sentiment. The impact on investor demand of not offering such protection may well now be considerably reduced. Demand and likely value for money would be confirmed through market testing prior to any sale being undertaken. Any long term costs associated with the sale of loans will, alongside the benefits, be reflected in the value for money assessment undertaken.

Work is on-going to inform a Government's decision on a potential sale but there are no plans for a sale in this Parliament.

Recommendation 16: The Government has told us that it has moved to the sale preparation stage with more up-to-date analysis underway. This analysis must produce a succinct but penetrative assessment of the market and we recommend that it be done as a matter of urgency. Without such an analysis, there is no guarantee that the Government

will make any of the financial returns that it claims. We further recommend that if the Government proposes to introduce a 'synthetic hedge' or similar it must share its scenario testing and specifically publish its estimate of the best-case and worst-case costing scenarios for this policy. (Paragraph 79)

The Department regularly assesses the markets relevant to the sale of income contingent loans. However, with no plans to conduct a sale during this Parliament, it will be necessary to conduct more up-to-date analysis as recommended by the Committee to inform an eventual decision on a sale.

As set out above, any long term costs associated with the sale of loans will, alongside the benefits, be reflected in the value for money assessment undertaken. Should a decision be made to proceed with a sale, we would, as per the requirements of the Sale of the Student Loans Act, provide a report into the value of a sale to Parliament within three months of sale completion.

Linking the student-loans to the removal of the cap on student numbers

Recommendation 17: Given that the Chancellor of the Exchequer has linked the removal of the student numbers cap to the sale of the income-contingent loan-book, we seek clarification from the Department whether the removal of the cap is dependent on the sale of the loan book. (Paragraph 84)

The removal of the higher education student numbers cap for high quality providers is not contingent on the sale of the loan book.

The Government has raised the cap on HE student numbers to fund up to 30,000 additional places in 2014/15 and will remove the cap on student numbers altogether in 2015/16,for publicly funded providers. Funding for this expansion is already agreed with HMT over the Spending Review period.

The Government's Higher Education funding reforms are designed to usher in a more diverse provision, more accountable institutions and more student choice. Going to university is a life-changing experience and the decision to raise and then abolish the artificial cap on student numbers will help to close the opportunity gap. This will support wider access to higher education, where a clear trend in recent years is that overall growth in student numbers has seen an increase in the proportion of students from disadvantaged backgrounds.

Recommendation 18: If the policy is not dependent on the sale, the Government must set out in its response where it will raise the £5.55 billion between now and 2018–19 required to remove the cap without putting an additional burden on the taxpayer. (Paragraph 85)

The Government believes that lifting the cap on student numbers is lifting the cap on aspiration. The precise costs of the policy will depend on the total number of students who take up places, and the ability of the higher education sector to respond to demand. This is a fully funded expansion, for which Government will provide £5.5bn of loan outlay between now and 2018-19. Decisions on the overall fiscal envelope will be taken at the next Spending Review

Presentation of data

Recommendation 19: The Government could have been clearer in the presentation of its figures on the policy of the loan book-sale and student numbers. We recommend that, in future, the Government clearly presents the net financial outcome of any such policy, rather than spreading the figures around different tables across large official documents. (Paragraph 88)

The Treasury reports the primary fiscal consequences of policy decisions taken at fiscal events. The 2013 Autumn Statement tables collate the policy changes that impact different measures; Public Spending (Table 2.1); and financial transactions impacting central government Net Cash Requirement (Table 2.5); public spending; net cash. The OBR's December 2013 Short-term Fiscal Outlook provides further information on forecast changes expected from both policy decisions to 2017-18.