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Student Loans

Seventh Report of Session 2017–19

Report, together with formal minutes relating to the report

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The Treasury Committee

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1 Introduction

1. In 2012, a fundamental shift in the way universities are funded took place. The major changes—often referred to as the "2012 reforms"—saw the cap on tuition fees raised from £3,000 to £9,000 (with tuition fee loans increased accordingly) and teaching grants significantly cut. Alongside this, the repayment threshold was increased from £15,000 to £21,000, and positive real interest rates were applied to student loan debt. Amongst other things, the 2012 reforms allowed the Government to relax controls on the number of students universities are able to recruit. The 2012 reforms had their genesis in the Browne Review—an independent review of higher education funding and student finance, led by Lord Browne of Madingley and published on 12 October 2010.[1]

2. The student loan system remains the subject of regular debate, with much attention paid to its fairness and sustainability. It is a topic that is likely to remain high on the political agenda for the foreseeable future, not least due to the Prime Minister's announcement that the Government will be undertaking a major review of university funding and student financing.[2]

3. The Committee has examined various aspects of the student loan system, including the impact of the system on public finances, the marketisation of higher education, and issues faced by students. However, the inquiry has not considered the optimal level of higher education funding. For its final evidence session as part of the inquiry—with the then Minister of State for Universities, Science, Research and Innovation, Jo Johnson (who was replaced by Sam Gyimah on 9 January 2018)—the Committee took to Twitter, asking those with experience of the student loan system to submit questions for the Committee to ask on their behalf. The Committee would like to thank all of those that participated in this initiative.

4. Higher education is a devolved issue, and the focus of this inquiry was largely on the English system. It should also be noted that this report focuses primarily on post-2012 student loans, often referred to as "Plan 2" student loans. Finally, the Committee recognises that the higher education sector comprises a diverse range of institutions, but the focus of this inquiry has been mainly on universities.

1 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010)

2 Speech by Theresa May to the Conservative Party Conference 2017, Renewing the British Dream, 4 October 2017

2 Public finances and the design of the system

Funding the student loan system

An overview

5. The majority of people in receipt of student loans—for tuition fees, maintenance, or both—will not fully repay them.[3] This is largely a product of two specific design features. First, repayments are contingent on income, meaning graduates only make repayments when their earnings surpass a given threshold, with these repayments set at a fixed percentage of income above that threshold. Second, the loans are written off after a defined number of years (currently 30 years for those starting their university education in England and Wales from 2012 onwards).[4] Student loans are therefore unlike typical bank loans, and student loan debt is unlike other forms of debt.

6. Following the Government's decision to increase the repayment threshold to £25,000 for all those who started university after 2012, the Institute for Fiscal Studies (IFS) forecasted that 83 per cent of graduates will not fully repay their loans. The Department for Education (DfE) puts this figure between 60 per cent and 65 per cent.[5] Every pound of student loan debt that is not repaid represents a cost to the taxpayer; it is money paid out by the Government that has not been recouped. This taxpayer contribution can be thought of as an investment in the country's skills base and productive capacity.

7. The Government has always intended a significant proportion of student loan debt to be written off. In oral evidence to the Committee, Jo Johnson, the then Minister of State for Universities, Science, Research and Innovation, said:

> The fact that debt is written off is a conscious, deliberate policy decision by the Government. It is not a symptom of a broken student finance system; it is a deliberate investment in the skills base of the country, which delivers benefits for individual students and for society at large.[6]

Lord Willetts—Minister of State for Science and Universities when the current student loan system was introduced—echoed this point in his evidence to the Committee:

> The 83 per cent of students, on one estimate, that may not repay in full—that is a deliberate policy decision, and it is very important that it is a policy decision that is taken democratically and that you can make alterations either way.[7]

8. It is only by including the value of the student loans written off that one can estimate the true size of the Government's higher education spending. It follows that the overall size of this spend depends heavily on student loan repayments, which in turn depend

3 IFS, "Higher Education finance reform: Raising the repayment threshold to £25,000 and freezing the fee cap at £9,250", Briefing Note BN217, 3 October 2017
4 Student Loans Company website, accessed 4 January 2018
5 Q239
6 Q196
7 Q98

on graduate earnings. Estimates of the cost to the taxpayer of funding higher education are therefore subject to a degree of uncertainty, as projections for graduate earnings can fluctuate in line with the economic outlook. The aggregate outstanding student loan balance was £89 billion at March 2017,[8] with the Department for Education estimating that between 40 per cent and 45 per cent of the value of student loans will not be repaid.[9]

The fiscal illusions of student loan accounting

9. Student loans are accounted for in two separate ways for the purposes of the National Accounts and the DfE Annual report and accounts.

10. The purpose of the DfE Accounts is to reflect a true and fair account of the Department's financial activities over the course of a financial year; they are prepared under the Government Financial Reporting Manual (FReM) issued by HM Treasury, pursuant to the Government Resources and Accounts Act 2000. The accounting policies contained in the FReM apply the International Financial Reporting Standards (IFRSs) as adapted or interpreted for the public sector context. For the past seven years the Government has produced "Whole of Government Accounts", which present a summation of all of the individual departmental accounts.

11. The purpose of the National Accounts is to provide a single coherent and exhaustive description of the economic activity of the UK as a whole; they are compiled by the Office for National Statistics (ONS). The framework underpinning the National Accounts ultimately flows from the UN's System of National Accounts, and the European System of Accounts (ESA2010).

12. The National Accounts are the basis from which Public Sector Net Borrowing (the 'deficit'), Public Sector Net Debt (the 'debt') and Public Sector Net Cash Requirement are derived, and are completely independent of the figures in the departmental accounts. Therefore, the treatment of student loans in the National Accounts directly impacts on the deficit and national debt in a way that their treatment in the DfE Accounts does not.

Student loans in the Department for Education Accounts

13. The treatment of student loans in the DfE Accounts is consistent with the established method of accruals accounting for loans. When a loan is issued to a student, an asset (i.e. the loan owed by the student to the Government) is created in the books of the DfE. When repayments are made, the loan balance (and size of the asset) is reduced. When interest accrues on the loan, the outstanding balance of the loan and size of the asset increases, and interest income is recognised.

14. A significant design feature of the student loan system is that a large proportion of the loans will be written off after 30 years. For accounts prepared on the accruals basis, where an asset is known to be permanently impaired,[10] the cost of impairment—also known as the cost of the write-off—must be recognised in full at the first opportunity. A student loan is written down in value if it is known that the recoverable amount of the loan is less than the value at which the loan is held in the accounts.

8 Department for Education, Consolidated Annual report and accounts 2016–17, July 2017, p 155
9 Q193
10 An asset (in this instance the student loan issued by the DfE) is impaired when its fair value (the higher of the value at which the asset could be sold, or the value of the future cash flows derived from the asset) is estimated to be permanently lower than the value at which it's held in the accounts.

15. At the end of every financial year, the DfE must consider whether the outstanding balance of the student loan assets is impaired. This consideration principally covers the new loans that have been issued in-year, but also covers the student loan balance brought forward from prior years that has already been subject to impairment tests in previous years. In 2016–17, the DfE issued £13.6 billion of new student loans.[11] Using its Stochastic Earnings Path (StEP) model,[12] which is based on future income growth, employment rates and interest rates, the DfE calculated that £3.9 billion of the loans (29 per cent) needed to be written off immediately. Of the student loan balance brought forward from previous years, an additional £1.8 billion[13] was written off.

16. The impairment on the initial outlay of loans is known as the Resource Accounting and Budgeting (RAB) charge.[14] This number defines what proportion of student debt the Government expects to write off. It will change from year to year, depending on the state of the economic forecasts that underpin the StEP model. The Government does not consistently publish the RAB charge,[15] although it can be calculated from the cost of new loans and the size of the write-offs, as above.

17. When the then Minister Jo Johnson confirmed the changes to the student loan repayment threshold in a written statement on 9 October 2017, he did not state what impact this would have on the RAB charge.[16] In evidence to the Committee, he stated that the new RAB charge would be "between 40 per cent and 45 per cent."[17] Had this RAB charge been applied to the student loans issued in 2016–17, the level of write-off in the DfE Accounts would be between £6.2 billion and £7 billion of the £13.6 billion of loans issued, rather than the £3.9 billion at present.

18. A 36 per cent RAB charge target was included within the 2015–16 BIS Annual Report. The fact that the current RAB charge is estimated to be at least 40 per cent could suggest that the previous target of 36 per cent of student loans to be written off has been abandoned. In evidence provided to the House of Lords Economic Affairs Committee, James Bowler—Director General, Public Spending at HM Treasury—said:

> The target has always been 36 per cent; we have not changed it since its inception. […] We and DfE will look at whether the target will remain the same now that the threshold has gone up. There is a potential case for changing the target rate, given the decision to put more subsidy in the system. We have a decision to make as to whether we reflect that in the target rate, rather than change the policy immediately to counteract it.[18]

11 Department for Education, Consolidated Annual report and accounts 2016–17, July 2017, p 155

12 Department for Business, Innovation and Skills, Guide to the simplified student loan repayment model, June 2015

13 Department for Education, Consolidated Annual report and accounts 2016–17, July 2017, p 155

14 Department for Business, Innovation & Skills: The RAB charge

15 The Department for Education, Consolidated Annual report and accounts 2016–17, July 2017, did not refer to the RAB charge.

The Department for Business, Innovation and Skills (BIS) Annual report and accounts 2015–16, July 2016, disclosed a RAB charge of 23 per cent, but erroneously included a target RAB charge of 28 per cent when it should have been 36 per cent, which Correction slip: Department for Business, Innovation and Skills Annual report and accounts 2015–16 subsequently corrected.

Prior to 2015–16, Department for Business, Innovation & Skills: The RAB charge, referred to PQ HL5098 [On Mature Students: Loans] 18 January 2016, stating a charge of "between 20 per cent and 25 per cent."

16 HCWS145 [Student finance update] 9 October 2017

17 Q193

18 House of Lords Select Committee on Economic Affairs, The Economics of Higher, Further and Technical Education, Evidence Session No. 5, Tuesday 7 November2017

19. Given that the level of repayment is dependent on wage growth, inflation and employment levels, the DfE has no ability to influence the RAB charge once the terms of the loans are set. Therefore, assuming university funding is to remain constant, if the Department is not meeting its RAB charge target, the only policy responses currently available are to alter the interest rate, repayment threshold, repayment rate or loan write-off period. As such, the RAB charge acts as a control on student loan write-offs for the Department, by forcing the Department to set the parameters of the loan repayment framework in a way that brings the RAB charge in line with the target.

20. The Government announced the sale of the first tranche of income contingent loans on 6 December 2017.[19] The sale achieved proceeds of £1.7 billion, and sold student loans with a face value of £3.5 billion.[20] When student loans are sold off, the final sales price of the loans would be compared to the value at which they were held in the accounts, and the difference between the two would be posted as either a profit or a loss in the income statement of the DfE. The profit or loss would not be expected to be very large because the sales price would be expected to be the loans' fair value, minus a risk premium to compensate the purchaser for taking on the risk that the loans do not pay back as currently expected. As the loans are already held at fair value in the accounts (because they have been subject to impairment tests every year), the loss on the loans should not be dissimilar to the risk premium achieved by the purchaser.

Student loans in the National Accounts

21. The National Accounts treat the issuing of student loans as a "financial transaction". A loan will be issued, due to be paid back in future, and unless the borrower fails to pay back there will be no impact on the deficit. In evidence to the House of Lords Economic Affairs Committee, James Bowler noted that the Government does not have a choice in determining how student loans should be treated in the National Accounts; noting that "ESA [20]10 is an international standard […] there are some snakes and ladders in the system. […] You must follow them and you cannot pick and choose when you do and when you do not."[21]

22. The National Accounts value the loans throughout their life at face value and do not assess them for impairment. Therefore, despite £3.9 billion (29 per cent) of the new student loans issued in 2016–17 being written off in the DfE Accounts, there is no impact of this write off in the National Accounts and therefore no impact on the deficit

23. A key concept of accounting is that transactions should be treated in a way that reflects how they appear in actual substance rather than in legal form, in order to present a true and fair account of an organisation's performance. Dr Andrew McGettigan, an expert on higher education policy, questioned whether it is reasonable to apply the financial transaction National Accounts accounting rules to student loans given the extent to which they differ from typical loans. He told the Committee:

19 HCWS317 [Government asset sale: Student Loans] 6 December 2017
20 Q217
21 House of Lords Select Committee on Economic Affairs, The Economics of Higher, Further and Technical Education, Evidence Session No. 5, Tuesday 7 November 2017

> The treatment of loans is set by these international standards, but, once you have made these loans so un-loan-like, there is a question about whether those standards are appropriate. The deficit measure is not capturing what is going on in loans here, and loans are flattering the deficit.[22]

24. For the purposes of the deficit, the National Accounts assume that the Government is receiving the interest on the student loans each year in full until the loans are paid off. The National Accounts ignore the Government policy that a large proportion of the loans, and the associated interest, will be written off after 30 years and therefore will not be received in full. The National Accounts therefore overstate how much interest the Government is earning each year, and the overall size of student loans that will be recovered. Sir Amyas Morse—Comptroller and Auditor General—told the Committee: "The fact that, effectively, the write-down in the value of the loan book does not have an impact on the National Accounts until the loan is actually written off means that it is all too easy to manage the impact."[23]

25. Were the Government to hold the loans for the full 30 years and then write off the outstanding balance, the losses would be recognised in the National Accounts—and in the deficit—in full in that year. However, when the loans are sold off, they are revalued down to the price achieved and transferred into the private sector. Sir Amyas Morse confirmed to the Committee "If the loan book were sold, they would not be obliged to book a capital loss in the National Accounts."[24] The process of selling off student loans before they are written off circumvents the losses ever being recognised in the deficit.[25]

26. Sir Amyas Morse said of the accounting presentation of student loans:

> It is important that it not be a position where the department comes out taking a loss and, actually, in the hands of the Treasury, it is not a loss. I would like to be reassured that that could not have any negative results. We are concerned by that, yes.[26]

27. **Due to the National Accounts accounting rules, there is no impact on the deficit when student loans are issued. As such, shifting the vast majority of all higher education spending into loans that are written off in 30 years has shifted nearly all higher education spending out of the deficit. Policy decisions taken today will have no impact on the public finances for the next 30 years. Based on the current RAB charge, £6–7 billion of annual write-offs are missing from the deficit. This figure is approximately equivalent to excluding the entire NHS capital budget from the deficit.**

28. **The National Accounts accounting rules stipulate that if student loans are sold off at a loss before they are written off after 30 years, there is no impact on the deficit whatsoever. The policy of selling off student loans prior to their write-off allows the Government to spend billions of pounds of public money without any negative impact on its deficit target at all, creating a huge incentive for the Government to finance higher education through loans that can be sold off.**

22 Q21
23 Treasury Committee, The UK's economic relationship with the European Union, HC 473, Q153
24 Treasury Committee, The UK's economic relationship with the European Union, HC 473, Q153
25 Office for National Statistics (STL 0048)
26 Treasury Committee, The UK's economic relationship with the European Union, HC 473, Q154

29. **The Government concluded its first sale of income contingent student loans in December 2017, when it sold £3.5 billion of loans, writing off £1.8 billion (51 per cent) of those loans in the process. The Government plans to sell off £12 billion of loans over the next five years. If the rate of losses on these sales is maintained, billions of pounds of student loan losses will be crystallised without having any impact on the deficit. Its inclusion would increase the deficit as forecast by the Office for Budget Responsibility (OBR) by 13 per cent, from £45.5 billion to £51 billion.**

30. **Political control over increasing Government expenditure is exerted through analysis of Public Sector Net Borrowing (the deficit) which the Government sets as its fiscal target. The OBR assesses whether the Government will meet this target and subsequently the majority of political debate on public spending is focused on it. As the writing off of student loans will have no impact on the deficit for the next 30 years, the large and increasing level of money spent on higher education makes no difference to whether the Government is meeting its target, and therefore escapes scrutiny. There is no effective control over the increasing fiscal cost of the student loan regime. Better oversight could be achieved through linking the Government's fiscal borrowing target to the Public Sector Net Cash Requirement, (how much money the Government actually needs to borrow).**

31. **The Government is not responsible for the international accounting rules that allow the fiscal illusions within student loans to exist. However, the National Accounts accounting rules regarding financial transactions were not intended to be used for loans that, as the Government readily promotes, are designed to not be paid back in full. Loans that are intended to be written off are, in substance, a partially repayable grant rather than a loan. The ONS should re-examine its classification of student loans as financial assets—which they are in legal form—and consider whether a portion of the loan should, in substance, be classed as a grant.**

32. **The Resource Accounting and Budgeting (RAB) charge is one of the most important numbers in the student loan debate. It presents, as a single figure, how much student debt the Government expects it will have to write off. Despite this, the 2016–17 Department for Education Annual report and accounts did not specify the RAB charge. The Committee recommends that it should be published prominently in the Department for Education's Annual report and accounts, and should be publicly updated alongside any changes to the student loan repayment framework.**

Is the sale of the student loan book value for money?

33. The Government announced the sale of the first tranche of income contingent loans on 6 December 2017.[27] The sale achieved proceeds of £1.7 billion, and sold student loans with a face value of £3.5 billion.[28] This represents a 51 per cent reduction in the face value of the loans upon sale to the market.

34. The performance of student loans as an asset class is subject to the risk that the overall level of employment falls and wages do not grow. It is very difficult for private companies to hedge against such risks. Therefore, when taking on an asset class that is exposed to these risks, private investors require a risk margin in the price they pay for

27 HCWS317 [Government asset sale: Student Loans] 6 December 2017
28 Q217

the assets. The presence of a risk margin is a cost to the Government because the receipts from a student loan sale are lower than the expected future cash flows of those loans. If the expected future cash flows were lower than the price investors had to pay, investors would not purchase the loans, as the loans would be loss making.

35. When the Government places a value on the future cash flows of student loans for the purposes of a sale, it applies a discount known as "the Social Time Preference Rate (STPR)". This rate is defined as "the value society attaches to present, as opposed to future, consumption".[29] Matt Toombs—Director, Student Finance and Analysis at the Department for Education—explained to the Committee why this rate was used:

> The assessment of value for money involved looking at the alternative uses the Government could make of the money that was held within those assets if it was invested elsewhere. That is why they looked at the Green Book value-for-money framework in assessing whether they could achieve value in selling the loans.[30]

36. The DfE Accounts state that the discount rate used to calculate the present value of student loans for the purposes of a sale is different to the rate used to value the loans in the Department's accounts themselves:

> The decision about value for money ahead of the sale would take account of a valuation of the loan book made on a different basis to that used to value the loans in the financial accounts. Under accounting policies, the amortised cost discount rate (currently 0.7 per cent) applies in the financial accounts. Any decision to retain or sell an asset on the Government's balance sheet involves an assessment of the retention value of the asset based on HMT's Green Book principles where a discount rate must factor in a social time preference rate (currently 3.5 per cent).[31]

37. The use of a higher discount rate when valuing the student loans for sale as compared to the rate used for valuing the loans in the accounts will place a lower value on the loans than the value at which they are held in the accounts. As noted earlier, Matt Toombs told the Committee that the use of the higher STPR is designed to capture society's preference for the alternative uses that the Government could put the sales proceeds towards, such as alternative policy spending.[32] However, the Government proceeds from the student loans sales will be used to pay down the national debt, rather than be reinvested in alternative policies. The then Universities Minister Jo Johnson told the Committee the first loan book sales were "a part of a much bigger programme of student loan sales that should raise £12 billion for the Treasury over the relevant financial period" and described it as an "important contribution towards how we are going to sort out our public finances."[33] The Chancellor of the Exchequer told the House of Lords Economic Affairs Committee:

29 HM Treasury Green Book, Annex 6, Paragraph 2
30 Q217
31 Department for Education Annual report and accounts 2016–17, Paragraph 5.25
32 Q217
33 Q220

> It is the Government's intention, where they find that they hold assets on the public balance sheet for which there is no policy or strategic reason, to realise those assets and thus reduce public sector debt.[34]

38. When the Government sells an asset such as student loans, it is exchanging one illiquid asset, the loans, for a more liquid asset, cash. Public Sector Net Debt (PSND) does not net-off debt with illiquid assets that the Government owns, but does so with cash, because cash can be used to pay off the deficit, and therefore is netted off to reduce the national debt. The Government can therefore reduce Public Sector Net Debt by selling illiquid assets for cash, but its actual fiscal position has not improved. The Office for Budget Responsibility and the International Monetary Fund (IMF) have described Government asset sales that reduce the net debt as a fiscal illusion:

> One risk posed by focusing on any particular fiscal aggregate is the temptation to set policy so that it has an effect on the chosen metric even if that is not a good guide to the effect on the underlying health of the public finances. The IMF describes such disparities as 'fiscal illusions'. PSND is susceptible to such illusions because it includes only a limited range of liabilities and an even smaller range of assets. This makes financial asset sales superficially attractive as they reduce a liability that 'scores' by reducing an asset that does not.[35]

39. **The Government is better able to manage an exposure to macroeconomic risks—such as low overall wage growth and low rates of employment—than the private sector. As a result, private sector investors require a large risk margin when taking on student loan assets from Government. The risk margin on the first student loans sale was, in aggregate, 51 per cent of the sale price.**

40. **Exchanging student loans for cash does not improve the Government's financial position, it merely exchanges one asset for another. Despite this, the sale does reduce Public Sector Net Debt. Such a fiscal illusion does little to improve the Government's financial position and may in fact cost the taxpayer money.**

41. **Such a high risk margin—and the fact that selling off the loans does not improve the Government's fiscal position—suggests the Government may be better off keeping student loans on its own balance sheet, rather than shifting the risks to the private sector and paying a large premium for doing so.**

42. **Whether the sale of student loans passes the Treasury's value for money test is heavily dependent on the discount rate used to calculate the future value of student loan repayments. As with all discount rates, there is a large margin for error. The Government has chosen a different discount rate for the purposes of the sale—a rate which places a lower value on the future repayments of the loans—than that which is used in the Department for Education Accounts. As part of its major review, the Government should consider using the same discount rate as that used in the Department for Education Accounts, as audited by the National Audit Office.**

34 House of Lords Select Committee on Economic Affairs, Chancellor of the Exchequer annual evidence session, Tuesday 12 September 2017

35 Office for Budget Responsibility Economic and Fiscal Outlook, November 2017

The funding split between the graduate and the taxpayer

43. The student loan system gives rise to a higher education funding model comprised of a contribution by the taxpayer and a contribution by the graduate. The larger the proportion of student loan debt that is written off, the larger the taxpayer contribution, and vice versa. Commenting on the funding split between the graduate and the taxpayer in a speech in July 2017, Jo Johnson said:

> Students pay on average roughly 65 per cent of the cost of the system through fees, while the taxpayer bears around 35 per cent of the cost, through teaching grants and loan subsidies, and a much higher share if we were to consider also the Government's £6 billion investment in research. This is a fair split of the cost of higher education.[36]

44. These comments were made before the Government announced its decision to increase the repayment threshold to £25,000 and to freeze the maximum tuition fee cap at £9,250. These changes were described by the IFS as a "significant giveaway to graduates", and they have had a material effect on the funding split between the graduate and the taxpayer. Estimates of the new split vary slightly. In its written submission to the Committee, Universities UK stated that students now bear 53 per cent of the cost and taxpayers 47 per cent,[37] whereas Jo Johnson told the Committee that the Department for Education now estimates that students bear 55 per cent of the cost and taxpayers 45 per cent.[38]

45. Given the taxpayer is now paying a share that is 10 to 12 percentage points larger than originally envisaged, the Committee asked the former Minister whether he still considered the split to be fair:

> Broadly speaking, it is roughly right that each group's share corresponds to the benefits that they receive from higher education in the form of the present value to the student of the higher lifetime earnings that they can expect and, for the public, the other benefits: the societal benefits that accrue from having an educated workforce and an educated population. If the splits correspond broadly to those benefits, it is a reasonable balance.[39]

Sustainability and changes to the model

46. The Office for Budget Responsibility has forecast that by 2021–22 total outstanding student debt will be seven per cent of GDP, or £160 billion.[40] In 2005–06, total outstanding student loan debt was £20 billion—less than one per cent of GDP.[41] The Committee asked the then Universities Minister Jo Johnson about the sustainability of the loan system, both from an economic and political perspective:

> It is a strong model that has been put into place over a number of years and has undergone various changes. It is sustainable and it is achieving its core policy objectives […] The repayment threshold [change] had the advantage

36 Speech by Jo Johnson to the Higher Education sector at Reform, "Delivering value for money for students and taxpayers", 20 July 2017
37 Universities UK (STL 0026)
38 Q190
39 Q190
40 Office for Budget Responsibility, Fiscal sustainability analytical paper: Student loans update, July 2016, p 10
41 Office for Budget Responsibility, Fiscal risks report, July 2015, p 225

> of benefiting students immediately in terms of the amounts that they would be required to pay […] It results in an immediate benefit to students of about £360 a year. That is cash in their hands that they would not otherwise have when they are in the repayment period, and it had that attraction.[42]

47. The Committee sought evidence on how the Government can pull various levers to modify the student loan system, including by retrospectively changing student loan terms. When asked about this, Lord Willetts said:

> It is inherent in the system—because this is a democratically framed public policy—that you can adjust the repayment terms. It was made absolutely clear to students that the terms could be adjusted […] My view is that there should be a fiveyear review, in which these parameters of the system […] are openly discussed.[43]

The National Union of Students commented on the information available to those taking out student loans, saying "It is not clear that the terms and conditions of the loan […] can be changed at the whim of government".[44] Its view was shared by MoneySavingExpert, who said "the Government does not communicate clearly enough with students and parents around the fact that the terms of their loan can change retrospectively".[45]

48. When asked whether changes to the 30-year write-off period would be considered as part of the Government's major review—announced by the Prime Minister at the 2017 Conservative Party Conference—Jo Johnson said:

> The review wants to examine the system to ensure it remains fair and effective, and the key elements of it—the interest rate, the threshold and the duration of the loan—are the kinds of levers that will always be under examination as we ensure that the balance of costs between students and taxpayers remains fair.[46]

However, the former Minister also told the Committee that he did "not expect radical change to the core architecture" as a result of the Government's review.[47] The Committee awaits the details of any actual review.

49. **It is undisputed that writing off a significant proportion of student loan debt is a deliberate design feature of the student loan system, making a student loan unlike any other form of loan or debt. In the absence of an effective explanation of the student loan framework—including the terms and conditions students are accepting—it is inevitable that the public will see write-offs as emblematic of a failing system. The criticism of retrospective changes which increase the burden on graduates as "unfair", levelled by MoneySavingExpert and the National Union of Students, is justified. The Government should cease this practice.**

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42 Q189, Q194
43 Q110, Q111
44 National Union of Students (STL 0029) para 27
45 MoneySavingExpert (STL 0046)
46 Q275
47 Q292

50. **The then Universities Minister Jo Johnson stated that the higher education funding system "is delivering [its] core policy objectives",[48] one of which is to "fairly share costs between the general taxpayer and the individual student".[49] The fairness of the funding split is subjective; the Government should instead aim to achieve a split that is economically optimal. It is not clear how large a range of funding splits the Government would consider optimal, given that the split has swung by 10–12 percentage points since the new repayment threshold has been introduced. The Government should define what it considers to be an optimal split to give greater certainty for future public spending.**

51. **The Committee welcomes the Government's planned major review of student financing and university funding. It is, however, regrettable that Jo Johnson effectively ruled out "radical change to the core architecture [of the student loan system]" in his oral evidence. The Committee hopes that Sam Gyimah, the new Minister for Higher Education, will approach the review with an open mind. The review must be objective, widely framed, and empowered to bring about any changes deemed necessary, be they radical or otherwise.**

52. **In his evidence to the Committee, Lord Willetts argued for a five-year review in which the parameters of the student loan system are openly considered.[50] There is merit in this proposal—which the Committee assumes would mean changes are made only after such reviews—not least for greater transparency. As part of its major review, the Government should analyse the benefits and drawbacks associated with introducing a pre-defined periodic review of student loan terms, and should ensure it takes account of the thoughts of students when considering the merit of this proposal.**

The interest rate

53. The interest rates applied to student loans represent one of the most widely discussed facets of the entire system. The relevant interest rates for post-2012 student loans are set out in Table One below.

Table 1: Interest rates for post-2012 student loans

Circumstances	Interest Rate
Whilst studying and until the April after leaving the course	RPI plus 3 per cent (equal to 6.1 per cent at the time of writing)
From 6 April after leaving the course until the loan is repaid in full	Variable rate dependent upon income. RPI (3.1 per cent at the time of writing) where income is £21,000 or less, rising on a sliding scale up to RPI plus 3 per cent where income is £41,000 or more
If the student does not respond to the Student Loans Company's requests for information or evidence	RPI plus 3 per cent, regardless of income, until the Student Loans Company has all the information it requires.

Source: Student Loans Company

48 Q292

49 Speech by Jo Johnson to the Higher Education sector at Reform, "Delivering value for money for students and taxpayers", 20 July 2017

50 Q111

The purpose of the interest rate

54. Whether interest rates at current levels can be justified is an area of debate. Former Universities Minister Jo Johnson explained the rationale behind the Government's policy in his oral evidence:

> It is trying to address two issues. The first is students who do not need the finance taking cheap debt and putting that money to speculative purposes. The second issue, but more important in terms of why it is there, is to have a progressive dimension to the system […] to enable the highest-earning graduates to make a bigger contribution towards the overall public cost of supporting higher education. They subsidise some of the costs that the Government incur in enabling people to go into higher education who do not then go on to repay their loans in full.[51]

55. In evidence to the House of Lords Economic Affairs Committee, James Bowler—Director General, Public Spending at HM Treasury—provided an explanation of how the interest rate services as a redistributive tool:

> … the IFS says that if you are in the top decile you will pay back £93,000 with the interest rates now, but if you did not have RPI plus 3 per cent but CPI plus 0 per cent you would pay back £53,000, so that is progressive. If you are in the system, the more you earn, the more you pay; but if you do not even get above the threshold, you do not pay anything. By the standards of progressivity in government, that is pretty progressive.[52]

56. The student loan system has complex redistributive effects. In general, graduates who are able to pay off their loan early pay less interest overall, and hence face a lower overall cost than those who pay off their student loan later. The most 'expensive' loans are paid by those with a high starting salary and slower career progression, such that they face a higher interest rate from the start, and pay off the loan capital just before the point of write-off.

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51 Q199

52 House of Lords Select Committee on Economic Affairs, The Economics of Higher, Further and Technical Education, Evidence Session No. 5, Tuesday 7 November2017

Chart One: Cumulative cost of student loans with the existing interest rate structure[53]

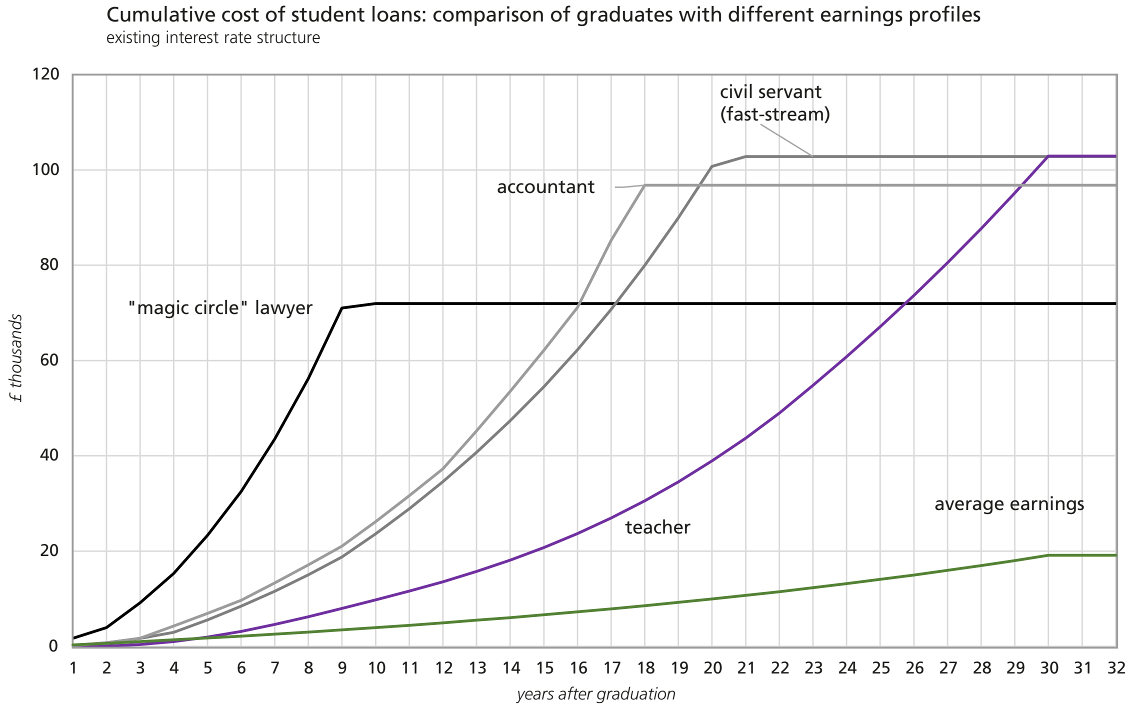
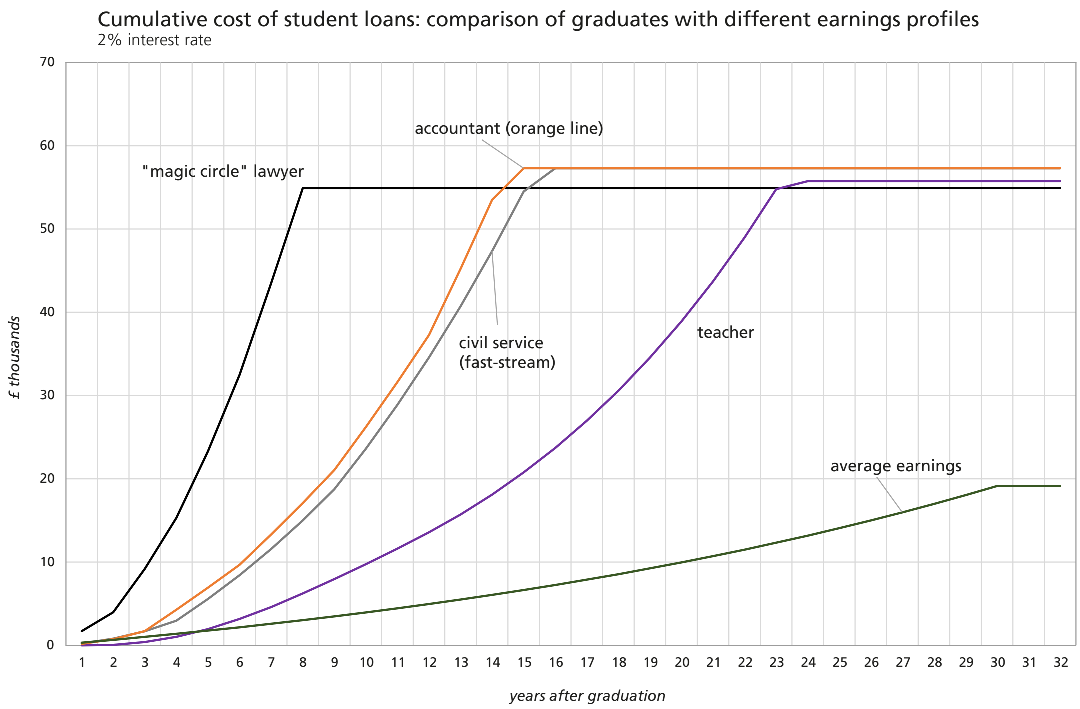


Chart Two: Cumulative cost of student loans with a 2 per cent interest rate



57. Chart One illustrates the cost of student loans, using indicative examples of graduates in different professions making steady progress through their careers. For comparison, the chart also shows the cost faced by a graduate whose earnings track the average across the economy. Overall, the civil servant, the teacher and the accountant pay broadly similar amounts for their loan, but a graduate joining a "magic circle" law firm pays less, owing to

53 A full explanation of earnings profiles and underlying assumptions can be found in Appendix 1

rapid pay growth in the early stages of their career. The graduate whose earnings simply track the average pays much less. The system is therefore capable of redistributing both upward, to the high-flying lawyer, and downward, to the graduate who does not benefit from a substantial pay premium. Chart Two shows that, if instead graduates are charged a "flat" interest rate of 2 per cent, the disparity between the lawyer on the one hand, and the accountant, civil servant and teacher on the other, is reduced.

58. Lord Browne—whose 2010 report heavily influenced the design of the existing student loan system—did not envisage interest rates at current levels.[54] In evidence to the Committee, Lord Browne stated that "we said that … the interest rate would be at the Government's cost of borrowing".[55] The Committee also took evidence from Dr Andrew McGettigan who, when asked about the interest rate as a mechanism to introduce a degree of progressivity into the student finance system, argued that this was not the Government's original intention.[56]

Perceptions of the interest rate

59. The public's understanding of the interest rate was a recurring theme in the Committee's evidence sessions for this inquiry. Former Universities Minister Jo Johnson said of the interest rate:

> It is a poorly understood feature of the system. […] Very few people understand the progressive nature of the interest rate—the fact that it is the most graduate tax-like element in the system, in a way, in the sense that it is progressive and it is redistributing resources from the highest earning graduates […] to those who are earning less.[57]

Lord Browne and Dr Andrew McGettigan echoed Jo Johnson's view that the interest rate is not well understood as a redistributive tool.[58]

60. Professor John Denham—who served as Secretary of State for Innovation, Universities and Skills between June 2007 and June 2009—told the Committee that "to an ordinary member of the public who knows that money can be borrowed far more cheaply than that, it just looks like a completely unfair charge".[59]

The use of RPI

61. The student loan interest rate is based on the rate of inflation as measured by RPI, with an additional surcharge depending on an individual's earnings. In March 2013, RPI was de-designated as a national statistic, and it has been roundly criticised as a flawed

54 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010)
55 Q98
56 Q83
57 Q200
58 Q6, Q123
59 Q131

measure of inflation, including by this Committee.[60,61,62] In a 2016 letter, the National Statistician, John Pullinger, strongly discouraged the use of RPI as an inflation measure.[63] More recently, the Chair of the UK Statistics Authority, Sir David Norgrove, expressed "regret that the RPI is still used more widely than for index-linked gilts, including for student loan repayments".[64] In its written evidence to the Committee, the Royal Statistical Society said:

> Instead of one or the other of the RPI or the CPI being used consistently by the government for indexation, these indices seem to be used very selectively indeed. It is grossly unfair that, presently, Government formulae which affect people's incomes (in the form of pension and benefit increases) often use the CPI, which normally provides a lower estimate of inflation, while several of their outgoings including student loan repayments […] are still related to increases in the RPI, which normally gives a higher estimate.[65]

62. When asked why RPI was chosen, Lord Willetts told the Committee:

> I cannot remember the arguments about which inflation measure to use. I would say that, back in 2010–11, RPI had not fallen so low in the esteem of the economics profession as it now has […] the main argument […] was the aim of making the system progressive.[66]

When the Committee asked the same question of Jo Johnson, he said:

> RPI continues to be used for various purposes […] It continues to have relevance as a measure in the context for which we are using it here, in the sense that it includes things that are relevant to students that CPI does not, including, for example, mortgage interest payments and council tax.[67]

63. It is correct that RPI does include mortgage interest payments and council tax payments, whereas CPI does not. However, households in which everyone is a full-time student do not have to pay council tax,[68] and it is uncommon for students to hold a mortgage. CPI also takes account of university accommodation costs, whereas RPI does not.[69] The NUS also supported the use of CPI over RPI.[70]

64. **The Committee sees no justification for using RPI to calculate student loan interest rates. RPI is no longer a National Statistic and has been widely discredited. In its Autumn Budget the Government acknowledged that the use of RPI was unfair for business rates, and the Committee is unconvinced by the case put forward for its use**

60 UK Statistics Authority, Assessment of compliance with the Code of Practice for Official Statistics: The Retail Prices Index (produced by the Office for National Statistics), March 2013
61 "Good luck to our latest measure of inflation, it's the best of a bad bunch", Paul Johnson, The Times, 21 March 2017
62 Treasury Committee, Autumn Budget 2017, HC 600, 22 January 2018
63 Letter from John Pullinger, National Statistician, to Sir Andrew Dilnot, Chair of the UK Statistics Authority, 9 March 2016.
64 Letter from Sir David Norgrove, Chair of the UK Statistics Authority, to Chris Giles, Financial Times Economic Editor, 15 September 2017.
65 Royal Statistical Society (STL 0047) para 2
66 Q127
67 Q203
68 Council Tax: Discounts for full-time students, Gov.uk, Accessed 4 January 2018
69 Office for National Statistics, Information Note: Differences between the RPI and CPI Measures of Inflation
70 National Union of Students (STL 0029) para 15

by the then Minister, in line with the Committee's report on the Autumn Budget. The Government should abandon the use of RPI in favour of CPI to calculate student loan interest rates.

65. **The Committee recognises the importance of preventing student loans being taken out to be invested, and it is right that the interest rate should seek to prevent this. However, given that tuition fee loans—which make up significantly more than half of an average student's stock of debt on graduation—are paid by the Student Loans Company directly to the university, there is little justification for applying high interest rates to the tuition fee element of student loans while students are studying. Applying an interest rate above the level of inflation to tuition fee loans whilst the student is still at university is perceived to be a punitive measure and should be reconsidered.**

66. **The Government has justified the existing level and structure of interest rates on student loans on the grounds that it is progressive. In reality, the student loan system has complex redistributive effects that are not strictly progressive. High-flying lawyers will generally pay less than teachers; but both will pay more than a graduate who does not receive a pay premium from their time in higher education. As part of its major review, the Government should re-examine the repayment system to address this anomaly so that the highest earning graduates are those that make the highest contribution .**

67. **The Committee is therefore unconvinced that the interest rates currently charged on student loans can be justified on redistributive grounds. Nor has any other persuasive explanation been provided for why student loan interest rates should exceed those prevailing in the market, the Government's own cost of borrowing, and the rate of inflation.**

68. **It is incumbent on the Government to ensure that the student loan system is well explained so that prospective students and their families are able to make well informed decisions. The Government must take steps to ensure that the student loan system—and particularly the interest rate—is well explained to those that it affects.**

3 Is there a market in higher education?

The marketisation of higher education

69. Higher education has undergone a process of marketisation in recent years. The Browne Review—an independent review of higher education funding and student finance, led by Lord Browne and published on 12 October 2010—contributed significantly to the reforms that sought to introduce this marketisation.[71]

70. The Browne Review envisaged a higher education market in which institutions "actively compete for well informed, discerning students, on the basis of price and teaching quality, improving provision across the whole sector".[72] In his evidence to the Committee, Lord Browne commented on the extent to which the current system resembles that proposed by the Browne Review:

> When we set up our report, we proposed something entirely different: first of all, that universities should only charge the basic cost of educating someone on a deskbased or lecturebased subject, and that expensive subjects should be supported by subvention from the Government. That fee would be £6,000, not £9,000. Secondly, we said that we would make sure that things like the interest rate would be at the Government's cost of borrowing. We felt, therefore, it was appropriate that the Government should pick up bad debts, but of a different scale, because educating the population was a good thing to do.
>
> […]
>
> Our proposal was a system, and strangely I regret that we did that, because the system only works if you have bought the whole thing. If you kept changing bits, it started not working[73]

71. When asked whether the current system was preventing a functioning market, Lord Browne agreed: "Without information and with caps, constraints and boundaries, many markets fail, and this is no exception".[74] In its 2017 report on the higher education market, the National Audit Office (NAO) described the marketisation process as follows:

> The government has increasingly delivered higher education using market mechanisms, relying more on student choice and provider competition to improve quality and value for money. Some 85 per cent of up-front funding now directly follows student choice (up from 23 per cent in 2007–08) via tuition fee loans, which the Department increased from £3,000 to a maximum of £9,000 in 2012 while reducing grant funding accordingly. The Department also removed student number caps from 2015–16, to increase access to more young people and allow popular providers to expand.[75]

71 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010)
72 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010), page 8
73 Q98, Q112
74 Q116
75 National Audit Office, The higher education market, 8 December 2017

Competition on the basis of price

72. The proposals put forward by the Browne Review were designed to generate price competition between universities. The specific tuition fee model proposed in Lord Browne's report involved no price cap, but a levy on fees above £6,000 paid by the university to the Government. Lord Willetts said of the proposal:

> John Browne's report is the most ingenious attempt at getting price variation in higher education that I have come across, and his proposal—to avoid it just being university fees and loans going up and up and up—was that you should have £6,000, and then above that universities could charge higher and higher fees, but there would be a levy extracted from them, in the words of his report, "to cover the costs to Government of providing students with the upfront finance."
>
> The argument was that [for] every extra £1,000, the proportion that we pay back must get lower and lower and lower, so there would be a levy, and it was going to be 40 per cent on the first £1,000 up to 75 per cent if you are on £12,000 fees, which was a very ingenious model.[76]

73. However, the Coalition Government chose not to introduce this model. In his statement to Parliament announcing the Government's proposals in 2010, Lord Willetts said:

> Lord Browne suggested that there should be no cap on the graduate contribution. We believe that a limit is desirable, and are therefore proposing a basic threshold of £6,000 per annum. In exceptional circumstances there would be an absolute limit of £9,000.[77]

74. Research by the IFS found that, in 2016, all but three of the top 90 institutions charged fees of £9,000 per year for all of their courses.[78] The Committee therefore examined whether, under the current system, there is any logic in expecting universities to compete on price, and for students to choose what and where to study on the basis of price. Dr Andrew McGettigan told the Committee that the nature of the student loan system dictates that a tuition fee cannot function as a price because, for many students, the fee charged will have no impact on the amount that is ultimately repaid:

> Because we have an income contingent repayment loan scheme, the tuition fee is not a price. It is not that it is not price sensitive. It is not a price. You may be faced with choosing to go to an institution that is charging £6,000, or one that is charging £9,000. You are also taking out maintenance loans, and let us say you go outside London, so you may graduate with over £40,000 rather than around £50,000 [of debt]. In terms of what repayments you are likely to make as a graduate, you may see no difference, particularly now that the repayment threshold is over £25,000. If you are meant to be a cost-sensitive, informed consumer, there is no difference. […] The tuition fee cannot signal like a price once you have a large subsidy built into the

76 Q116
77 Oral statement to Parliament, Statement on higher education funding and student finance, 3 November 2010
78 IFS, Higher Education funding in England: past, present and options for the future, Briefing Note BN211, July 2017

> scheme. You are trying to do two contradictory things. On the one hand you have a loan scheme that is trying to mimic a proportionate, if not a progressive, graduate tax. On the other hand, you are trying to use a price signal to achieve everything that you are meant to get from efficient markets. The Browne Report in 2010 said price is the single best indicator of quality. It can do no such thing in this situation.[79]

75. He went on to explain why this contributes to the lack of variation in tuition fees:

> That is why it [the tuition fee] is the same at every institution. If you are faced with this decision and you think, "I could go to that one that is charging £7,000 or that one that is charging £9,000", you go to the one charging £9,000. That is £2,000 per year per student that is going into the institution, even if it is not being spent directly on you. That is going to play out in all sorts of ways in the long run, such as institutional prestige. If it goes into research you will get the institutional prestige benefit.[80]

76. Commenting on the prospect of students choosing where to study on the basis of the tuition fee, Lord Willetts said:

> When you have a graduate repayment system that is as generous as it is, any student who said, "I am going to Leeds because it is £7,500, and I want to save money on York, which is £8,250", would not really be understanding the basics of the system.[81]

77. The NAO noted that "There is no meaningful price competition in the higher education sector [...] Providers are incentivised to charge the maximum, even for courses that cost less, because not to do so could suggest poor quality and reduce demand instead of increase it."[82]

78. Former Universities Minister Jo Johnson provided a slightly different explanation of why almost all university courses command the maximum fee, focussing on the costs and revenue associated with teaching. He said:

> It is not surprising, in a system in which you have a cap that is set at this level, that you are not seeing much price differentiation between providers at the moment. Most bands of courses are in deficit on teaching, in terms of their teaching costs versus the revenue they get in. In that situation, you would expect them to be charging as close to the cap as they can.[83]

79. **In implementing the 2012 reforms, contrary to the recommendations of the Browne Review, the then Coalition Government chose to introduce a cap on tuition fees. The evidence provided to the Committee suggests this was done in the knowledge that it would create a market with no meaningful price competition. Whether price competition in the higher education sector could ever be a realistic, or desirable, prospect—even without a tuition fee cap—is debatable; the incentives for students to choose courses that command smaller tuition fees are weak.**

79 Q9
80 Q9
81 Q103
82 National Audit Office, The higher education market, 8 December 2017
83 Q244

80. **Nevertheless, the Coalition Government's expectation in advance of the 2012 reforms was that competition from new market entrants—combined with additional obligations for those universities choosing to charge above £6,000—would lead to prevailing tuition fees of around £7,500. It is overwhelmingly clear that this was a naïve assumption. Given that fees are almost universally well in excess of the level the Government intended when introducing the new fee regime, the Government should explain, and explore in its expected review, why the higher rate of fees being charged is desirable. In England, the consequences of reducing the maximum tuition fee to £7,500 or £6,000, as some have advocated, would be that the highest earning graduates pay less, and the level of funding for universities would be reduced, without either a significant increase in subsidy from the taxpayer or, more likely, the reintroduction of caps on student numbers.**

Competition on the basis of quality

81. The Browne Review envisaged competition between universities on the basis of quality, as well as price. In its report on the higher education market, the NAO said of competition on quality:

> Market incentives for higher education providers to compete for students on course quality are weak. The relationship between course quality and providers' fee income is weak. We found that, on average, a provider moving up five places in a league table gains just 0.25 per cent of additional fee income through increased student numbers.[84]

82. Multiple witnesses told the Committee that universities compete fiercely to recruit students. Lord Willetts commented that:

> We do have competition, in a better form than price competition: we have competition to recruit students. […] Since the removal of numbers control, universities compete very actively for students, and some have grown a lot, and others have shrunk. It is competition, driven by student choice.[85]

83. Competing to recruit students could see universities seeking to attract applicants by ensuring courses are of high quality, but could also be manifested through significant investment in marketing and advertising. The NAO noted:

> Providers are attempting to attract students by investing more in marketing and in facilities, with capital investment in English universities increasing from £2.35 billion to £3.80 billion between 2011–12 and 2015–16. Stakeholders we spoke to were concerned that this investment would not lead to a proportionate increase in teaching quality, and was unsustainable.[86]

84. **The current structure of the higher education market creates financial incentives for universities to recruit more students, yet the NAO has found that market incentives to achieve such expansion by improving course quality are weak. It is wrong to assume that the competition to recruit more students will be played out through competing on the basis of quality. If pursued recklessly, the aim of attracting ever greater student**

84 National Audit Office, The higher education market, 8 December 2017
85 Q106
86 National Audit Office, The higher education market, 8 December 2017

numbers can be damaging. The fact that university spending on marketing is increasing shows that universities can compete in ways that do not deliver any educational improvements. The market mechanisms the Government has applied to the sector are not, in and of themselves, sufficient to drive meaningful improvements in quality.

Student choice

Information available to students

85. The Browne Review noted that "students need access to high quality information, advice and guidance in order to make the best choices", and that they must be able to adequately assess the relative quality of different courses.[87] Former Universities Minister Jo Johnson told the Committee:

> Informed choice is absolutely critical to the operation of the higher education system, and I have been concerned that students are making choices based on factors that are not necessarily the ones that they should be prioritising. People have been prioritising where their friends are going to university, where the nightlife is great and so forth. We need them to be focusing on where the teaching is of the greatest quality and where the student outcomes are best.[88]

86. The Committee took a range of evidence on the impediments to informed choice that exist in practice, including the lack of an effective price signal as discussed earlier in this report. Dr Helen Carasso—a higher education academic at St Anne's College, Oxford University—explained that higher education is an "experience good", in the sense that necessary information (in this case, on teaching quality) is only available after it is of any use.[89] Professor Janet Beer—Vice Chancellor of the University of Liverpool and President of Universities UK—told the Committee that there is "too much information out there" for prospective students, while Lord Willetts commented that "information for students is still not good enough".[90] The NAO also noted that while the provision of information has improved, its use is not widespread.[91]

87. The Committee heard that in the absence of a functioning price signal, students may use other metrics to judge the quality of courses. One such metric is the Teaching Excellence Framework, which Dr Andrew McGettigan described to the Committee as "a synthetic signal: gold, silver or bronze. It is meant to be quite simple for people to grasp in the absence of a price signal."[92] Jo Johnson also noted that the Framework is seeking "to provide students with another signal of where quality can be found in the system".[93] Dr Helen Carasso mentioned that a university's entry tariff can also serve a similar purpose, saying:

87 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010)
88 Q245
89 Q67
90 Q138, Q119
91 National Audit Office, The higher education market, 8 December 2017
92 Q70
93 Q244

> They [applicants] see [the entry tariff] as being a proxy for quality and the prestige of the qualification they are coming out with. It is a crude proxy, but that is how they perceive it.[94]

88. **If the Government is committed to creating a higher education market that functions effectively, it must take steps to improve both the quality and dissemination of information. Without adequate information, an efficiently functioning market will struggle to develop. Prospective students face the unenviable task of determining whether to participate in higher education based on increasing quantities of university marketing material coupled with a lack of proven, reliable metrics for judging the quality of courses. It is vitally important that students are able to make informed choices about what and where to study. Such decisions are typically taken at a relatively young age, yet they carry significant long-term implications.**

89. **The Committee notes that the Office for Students will be tasked with developing the Teaching Excellence Framework further by taking it to subject level. This is a sensible step, but the Committee fears the Government's efforts may be wasted if it fails to address the fact that so few students are currently making use of information that is already available.**

94 Q75

4 University finances

The impact of the 2012 reforms

A windfall for universities?

90. One of the principles underpinning the Browne Review was that "more investment should be made available for higher education". The report states:

> The current system puts a limit on the level of investment for higher education. As a consequence we are at risk of falling behind rival countries. Our proposals introduce more investment for higher education. Higher Education Institutions must persuade students that they should 'pay more' in order to 'get more'. The money will follow the student.[95]

This aligns with evidence provided to the Committee by Lord Willetts, who said of the Browne Review:

> The view was, "We have had the financial crash. We have fiscal pressures. There is going to be pressure for saving public spending. It is going to be very hard to exempt higher education from those pressures […] We need to find a way of going a step further beyond the £3,000 to ease the pressures that higher education is going to be under. We need a review that makes this possible".[96]

91. The Committee sought to understand the impact of the 2012 reforms on university finances. Dr Helen Carasso told the Committee:

> The other thing here is the unit of resource that is available to teach each student place. Was there enough resource in the system in 2011–12? Many universities would say no, there was not, and that there is now a level of resource closer to what is needed.[97]

In a similar vein, Dr Andrew McGettigan said "the English university sector has more income since 2012" and that "the sector was spared austerity, but there have been market effects, so not every university has the same income that it would have had."[98] These views are echoed by the IFS, which said the following in a 2017 Briefing Note:

> The 2012 reform increased the total level of resources universities receive per student per degree by around 25 per cent from £22,500 to £28,000 in 2017 prices. This was a result of the increase in tuition fee income exceeding the loss in teaching grant income. The falling real value of the fee cap since 2012

95 BIS, Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding and Student Finance (2010), page 4
96 Q110
97 Q4
98 Q32, Q34

> has reduced funding per student at some universities, but the average figure has been offset by increasingly more universities charging the maximum possible fees and by reductions in fee waivers and bursaries.[99]

Professor John Denham told the Committee "there is no doubt that [the 2012 reforms were] originally a windfall".[100]

92. Lord Willetts told the Committee that the 2012 reforms brought about an increase in university funding which was needed:

> The trajectory of resource per student had been [in] decline through the 1980s and 1990s. The decline had been arrested by the £3,000 fees, and it was then about flat, but it was flat at a historically low level. My view was that we could only seriously enter the debate about the quality of teaching in higher education if universities did not have the compelling alibi, "If you keep on reducing unit of resource, what do you expect?" I personally thought that the unit of resource per student did need to go up.[101]

93. When asked by the Committee whether he thought that the 2012 reforms represented a windfall for universities, former Universities Minister Jo Johnson concurred with Lord Willetts, saying the changes were needed to address a historic funding shortfall.[102]

94. The Committee also took evidence from two current university Vice Chancellors: Professor Janet Beer, Vice Chancellor of the University of Liverpool and President of Universities UK, and Professor Mark E Smith, Vice Chancellor of Lancaster University and Chair of the Financial Sustainability Strategy Group at the Higher Education Funding Council for England. When asked whether universities have experienced a significant increase in per-student funding since the 2012 reforms, Professor Mark E Smith said:

> There has been an increase but [funding per student of] £9,000 or even £9,250 is not historically high. If you look back at 1989–90 and project it forward to 2012, the value we got per student then was £9,600. What then happened [...] was that there was a longterm decline to a minimum of £6,400, which the £3,000 fee and then the £9,000 fee addressed.
>
> [...] Although there has been an uplift, it has been to replace all the things like the loss in the capital grant [...] If you are asking, "Is £9,000 overinflated?" the numbers do not say that.[103]

Cross-subsidy between courses

95. The Committee's inquiry explored whether the 2012 reforms have created an incentive for universities to offer courses that are cheaper to run, in the knowledge that they are likely to receive maximum fee income regardless of the cost of putting on a course. Dr Andrew McGettigan told the Committee:

99 IFS, Higher Education funding in England: past, present and options for the future, Briefing Note BN211, July 2017
100 Q104
101 Q101, Q102
102 Q227
103 Q146

> There is an incentive in the system. The classroom subjects, for example social sciences, arts, humanities, law, business [...] previously would have attracted a unit of resource of about £6,000. They used to get a lower level of unit of resource through the combination of institutional grant and fee. They are now able to charge £9,000 for those courses. [...] For the classroom subjects, there is an incentive to recruit more of those students.[104]

96. On the subject of whether there is any evidence to suggest that universities have increased their provision of cheaper courses relative to those that are more expensive, Professor Mark E Smith told the Committee:

> The answer is no. If you look at the number of people going into high-cost subjects compared with low-cost subjects, there has been an increase overall, because obviously the registrations have gone up. Those classified as low-cost have gone up by four per cent over the last two or three years, whereas the high-cost subjects have gone up by nine per cent, particularly around biological sciences and biomedical-related courses. They have been very popular.

97. However, in its 2017 report on the higher education market, the NAO expressed a different view, saying:

> Providers reported that teaching grants for high-cost courses do not cover additional costs, creating incentives to prioritise lower-cost subjects. We found examples of providers opening or expanding cheaper classroom-based courses to strengthen their overall financial position. [...] Pressure to prioritise lower-cost courses is often balanced by other incentives, for example to maintain a provider's reputation or graduate outcomes. As such, most providers we spoke to sought to maintain expensive but important subjects, and covered additional costs with cross-subsidies from other areas including fees from international students, commercial income or, in some cases, lower-cost subjects.[105]

98. **Against a backdrop of sustained reductions in public spending, the 2012 reforms saw university funding increase significantly. The sector was spared austerity. The provision of extra resource to universities sought to bring funding up to an appropriate, sustainable level that could ensure the delivery of high quality teaching outcomes. The country's universities are an asset, and are rightly admired internationally; a point that is often forgotten in public discourse.**

99. **The Committee heard that universities are not awash with cash, rather, they are now being funded sustainably, with teaching now typically breaking even. This position must be maintained to ensure that we defend the UK's world-class higher education system.**

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104 Q41

105 National Audit Office, The higher education market, 8 December 2017

5 Issues for students

Complexity

100. Many witnesses expressed the view that the student finance system is overly complex, making it difficult for prospective students to understand. Amatey Doku—Vice President for Higher Education at the National Union of Students—noted that prospective students are required to comprehend the system at a relatively young age, and that changes to student loan terms generate further complexity. He said:

> To expect 17 year-olds to go into making this choice fully informed is sometimes unfair […] Even if you understand it as you are going in, it has been retrospectively changed and the loans have been sold off, so all that makes it very difficult terrain.[106]

101. Dr Helen Carasso reflected on discussions held with university applicants, and highlighted the fact that even experienced economists can struggle to understand the system. She told the Committee:

> We are talking as, in some cases, very qualified economists, and we are confused about it. I have had a number of people who say, "I cannot work out the costs. I cannot work out what it means."
>
> We are talking about the signals that are being sent out here to people who cannot unpick them. It is not because they are financially illiterate. It is mixed signals, because they are very complicated signals, and they do not even have the full evidence.[107]

102. Dr Andrew McGettigan noted that the Government's decision to fund universities primarily through student loan write-offs—instead of through direct grants as in the past—can be difficult to comprehend:

> Now we have a scheme with much higher fees but which appears to cost the same. That is very difficult for people to interpret. There is a lack of transparency there.[108]

Terminology

103. The Committee's inquiry examined the logic behind, and the impact of, the Government's choice of terminology. Specifically, the Committee was interested in the use of the terms "loan" and "debt", and whether they contribute to the system not being well understood. In its written evidence submitted to the inquiry, MoneySavingExpert argued:

> The Government *must* get rid of the language of debt. It is simply misleading. Calling the current system a "loan" makes it more difficult to explain and puts potential students off. Using the language of debt means people unnecessarily fixate over the total amount they borrow and interest rates, rather than the rate of repayment which is arguably most important.

106 Q183
107 Q8
108 Q4

> […] Reforming the language to a graduate contribution system would help prevent people being put off from studying, or making ill-informed financial decisions, such as using savings to pay their children's tuition fees to "save them from a lifetime of debt".[109]

104. Numerous witnesses noted the unhelpfulness of the current terminology in their oral evidence to the Committee. Referencing the fact that student loan repayments are conceptually similar to an additional tax on income but the terminology leads many not to think of it in that way, Professor Janet Beer said:

> Nick Barr [Professor of Public Economics, London School of Economics] said a very interesting thing in the lead-up to this change in the student funding system. He said that no parent ever stayed awake at night worrying about how much tax their son or daughter would pay in the future.[110]

105. Lord Willetts said of the terminology:

> Saying, "If you are in a well-paid job, you will be paying back the cost of your higher education", is not like a student getting into debt and having to service it. We are all trapped in that language, and I very much regret it. It is a very misleading picture.[111]

106. In evidence to the House of Lords Economic Affairs Committee, Martin Lewis—Executive Chair of MoneySavingExpert—commented on the loan statements provided by the Student Loans Company, saying:

> Each month, people get a statement telling them that £400 of interest has been added to their student loan. They ask, "Should I pay it off?" I ask how much they are earning and it is £23,000 a year. I say, "No. If you paid off £10,000, you would still pay 9 per cent of everything you earn above £21,000 for 30 years". The best advice for most students is to rip up their student loan statement because it is psychologically damaging and completely misleading.[112]

107. Even Jo Johnson agreed that "The language of debt and interest is not particularly helpful […] It would be preferable for us to use language […] that thinks of it more as a time-limited and income-linked graduate contribution, because that is what it is."[113]

108. **It is clear that the student loan system is complex, and has become even more so as a result of piecemeal changes to student loan terms. In conducting its major review of university funding and student financing, the Government must be mindful of the risk that additional changes lead only to more confusion. The Government should take this opportunity to simplify the system and significantly improve how it is explained. Prospective students must be able to easily comprehend the system, given the long-lasting financial implications of accessing student finance. It is the Government's responsibility to ensure that a good understanding of the system is commonplace.**

109 MoneySavingExpert (STL 0046)
110 Q181
111 Q132
112 House of Lords Select Committee on Economic Affairs, The Economics of Higher, Further and Technical Education, Evidence Session No. 2, Tuesday 7 November2017
113 Q237

109. **Student loan debt is only repaid when earnings surpass a given threshold and is written off after a defined number of years. It should not be thought of as akin to typical debt. In using the terms "loan" and "debt", the Government has made it all too easy for students and their families to think of it in this way. It is easy to imagine how the thought of accruing tens of thousands of pounds in so-called "debt" could serve as a deterrent for young people considering applying to university, and the Committee is concerned by the thought of prospective students choosing not to enter higher education due to misperceptions about the nature of student loan debt. Loan statements sent by the Student Loans Company are likely to have reinforced this troubling misconception, and must be improved to better convey the true nature of student loan repayments.**

110. **The Committee welcomed the former Universities Minister's admission that alternative language would be preferable. The Government should introduce new language that better reflects the workings of the student finance system.**

Is it a graduate tax?

111. Student loan repayments can be thought as sharing some conceptual similarities to an additional tax on income. While students will leave university with a notional stock of debt, this serves only to determine the length of time for which they will be required to make repayments, not the size of the repayments themselves. As discussed earlier in this report, actual repayments are currently fixed at nine per cent of income above £21,000 (rising to £25,000 in April 2018). Lord Willetts told the Committee that the current system is "tax-like" and "has many of the good features of a tax".[114] However, a key difference between the existing student loan model and a so-called "graduate tax" is that repayments end once the debt has been paid off or written off, whereas graduate tax payments would theoretically continue in perpetuity. Jo Johnson described the current system as having "similarities to a graduate tax but also important differences that make it a better system".[115] In taking oral evidence, the Committee asked Lord Browne why his review did not propose the introduction of a graduate tax:

> There was no evidence that the Treasury would permit hypothecation of a tax to a specific activity. We asked them; they said, "We have no statement to make on this"—i.e. they would not do it. Secondly, there is the amount of time it would take to build up revenue, because the taxation is for students, and we would have a lot of time to build up the needed revenue.
>
> The third thing was that it went against the question of, "Can you use the mechanisms involved with students paying to make sure that quality is maintained and improved?" It would just be a tax, and everyone could get away with whatever they wanted to do as long as they paid the tax. We felt that on balance, while it did many of the similar things to do with finances, it was not quite the right thing to do at the time, and I still think it is not the right thing.

114 Q109
115 Q238

Lord Willets added:

> [A tax will] create perverse incentives for students who are going to do a course that is strongly associated with higher pay to go and study abroad, because you have removed the link between the amount you repay and your specific higher education. Being a graduate of an English university means that you are saying, "I am going to have a lifetime of income tax at whatever rate is higher", massively more than the actual cost, so it suddenly becomes a bargain to pay to go and study abroad, and that would be very unfair on our universities.
>
> Secondly […] because none of this can be hypothecated, it all clearly counts as public spending, and that is where the problem starts.[116]

112. When asked by the Committee if it would be beneficial to introduce a time-limited graduate tax, Dr Helen Carasso said:

> If you did that it might be easier in the simple accounting methods, but it raises quite a lot of questions about where the money would go and how the funding would go through into the system and institutions. You would go back to some sort of teaching grant model.[117]

Maintenance loans and grants

113. Students have the option of taking out a maintenance loan to help meet their living costs whilst at university. The size of the loan that a given student is eligible for depends on where they are studying, whether they are living away from home, and their household (parental) income. The Committee examined whether maintenance loans are intended to meet students' living costs in their entirety, or whether they represent only a contribution that students or their parents will need to supplement. The Committee asked whether the fact a student's maintenance loan entitlement depends on their parents' income implicitly means that the Government expects parents to contribute to living costs. Jo Johnson said:

> There are a number of different ways in which students can bridge what may be a gap between the amount that they can borrow for their maintenance costs and the actual costs that they incur. They come in a number of forms. Parental contribution will, for many, be part of that picture, but it is not the only part. They also have an ability to use their own savings, should they have any, or to work while they study to bridge any funding gaps they have. […] The Government are not being prescriptive about a parental contribution. It has always been the case that the Government's contribution towards living costs has been just that—it has been a contribution. It was never meant to be a blank cheque whereby it covers all maintenance costs for students, whatever they might be. It is a function of the fact that limited resources are available to Government inevitably and they have to be targeted towards those who are most in need of them. A proxy for that is household parental income. That is the proxy by which we get to addressing the question of the

116 Q107, Q108
117 Q51

> respective needs of particular student groups. […] The government system was never intended to cover the entire amount of a student's maintenance costs.[118]

114. In its written evidence, MoneySavingExpert said the "Government does not communicate clearly the implicit parental contribution", adding that:

> Many students don't get the full maintenance loan, and parents are meant to fill the gap. However, nowhere in the main Student Loans Company communications does it explicitly say this–the most is a statement that "depending on their income, parents may have to contribute towards the living costs of their student children".
>
> It must be the Government's (or its agencies') duty to explicitly inform parents about the parental contribution, including exactly how much they are expected to give. Not doing so causes rifts between students and parents who don't make up the gap, as well as budgeting problems which are sometimes so severe that students are forced to leave university.[119]

115. MoneySavingExpert also argued that "the maintenance loan is too little money in the first place", meaning that "the biggest practical problem that students face is merely affording to live while studying".[120] Jo Johnson told the Committee that "students are pushing us to be more generous on the maintenance side".[121] The Government has previously commissioned research to allow it to understand better the financial position of students studying in England, known as the Student Income and Expenditure Survey. The most recent survey was conducted in 2014–15, but has not yet been published by the Government. The Committee asked the then Minister why this is the case, and he said:

> We are quality-assuring it at the moment. It is a big, complex piece of research and we want to ensure it is right. The department has a huge amount on its plate at the moment and we have to prioritise, but it is being quality assured and when it is ready we will publish it.[122]

116. Students were previously able to apply for maintenance grants, but the Government announced its decision to scrap these grants in the Summer Budget 2015, which said "the expansion of higher education relies on funding being put onto a sustainable footing. The Government must therefore ask graduates to meet more of the cost of their degrees once they are earning. From the 2016–17 academic year, maintenance grants will be replaced with maintenance loans".[123] Lord Browne told the Committee that he felt strongly about the Government's decision to eliminate maintenance grants, saying "That was, in my mind, a bad thing".[124]

117. Students from low-earning households are eligible for larger maintenance loans. This means that those students typically graduate with a larger stock of debt than students from high-earning households (who are eligible for smaller maintenance loans). The

118 Q272, Q273, Q274
119 MoneySavingExpert (STL 0046)
120 MoneySavingExpert (STL 0046)
121 Q242
122 Q257
123 HM Treasury, Summer Budget 2015
124 Q112

Committee heard that large debts could deter some prospective students, but Jo Johnson's view was that "we are not seeing the current system of student finance deterring people from disadvantaged backgrounds going into higher education".[125] He added that "A better way of looking at it […] is to say Government are making available the most financial support to those who need it most, and that is what Governments should do.[126] On this subject, Amatey Doku said:

> We were very clear, when maintenance grants were scrapped, that that was the wrong thing to do, and we have been very clear that maintenance grants need to be reintroduced. We cannot have a system where students from more disadvantaged backgrounds will come out with bigger debt.[127]

Professor Janet Beer echoed this point, telling the Committee that "we need to return to means-tested maintenance grants".[128]

118. **Maintenance loans are equally, if not more, difficult than tuition fees for prospective students to understand. The Government sends mixed messages; former Universities Minister Jo Johnson told the Committee that maintenance loans are not intended to cover a student's living costs in their entirety, but that the Government is not being prescriptive about an expected parental contribution. This may mean that some students who lack access to additional sources of income are priced out of a university education. This is clearly at odds with the Government's stated aim of removing barriers to access—the Government should consider how to address this as part of its major review.**

119. **The former Minister's assertion that the Government does not assume parents will contribute to living costs is directly contradicted by official Student Loans Company documentation, which states that depending on their income, parents may have to contribute towards the living costs of their student children.[129] The assumed parental contribution will undoubtedly create financial pressure for households with multiple children at university, and the Committee is unconvinced that the maintenance loan system adequately accounts for this. The fact that parents are expected to contribute to living costs must be made much more explicit. Alternatively, if the Government maintains that it does not expect a parental contribution, Student Loans Company documentation must be corrected, and the Government must explain how university is free at the point of use for students without additional sources of income.**

120. **It is vital that public debate on the issue of maintenance loans is well informed. It is deeply regrettable that the Government is still yet to publish the 2014–15 Student Income and Expenditure Survey, which will clearly be highly informative in helping the public understand students' financial circumstances. The value of the survey's findings is no doubt diminishing with the passage of time. The Committee recommends that this information is published urgently. The need for maintenance grants to be reintroduced has also been highlighted to the Committee, and the Government should assess the case for doing so as part of its major review.**

125 Q256
126 Q261
127 Q156
128 Q181
129 Student Loans Company, Student Finance: How you're assessed and paid 2017/18

Other issues

Part-time students

121. From a peak of almost 590,000 in 2008–09, part-time student numbers fell to just over 310,000 in 2015–16; a fall of 47 per cent.[130] Given the timing, it is reasonable to link this decline to the 2012 reforms, due to the increases in tuition fees, reluctance among mature students to take out loans, and the fact that many would-be part-time students are ineligible for tuition fee loans. In its written evidence to the Committee, the Open University—whose student numbers fell by 30 per cent between 2010–11 and 2015–16[131]—said "This catastrophic decline in part-time higher education was unanticipated and counter to the UK Government's policy objectives. […] this collapse in part-time higher education is the symptom of a broken market."[132] Both Lord Browne and Lord Willetts told the Committee they regretted the way in which the reforms had affected part-time students,[133] with Lord Willetts saying:

> I plead guilty on part-time students. I was surprised at the time, and remain shocked, by what happened. […] We hoped and expected—it did not turn out like this—that the extension of the fee loans would help the part-time students. It clearly did not work out that way. The lesson I learned from this is […] that there is not a single model that works for all students. […] The evidence is that repayable loans work for some, like 18 year-olds going to university for three years, and do not work for others, like part-time students.[134]

122. **The Committee agrees that the sharp decline in part-time student numbers—brought about in part by the 2012 reforms—is regrettable. It is clear that the Government failed to anticipate the impact the 2012 reforms would have on part-time students. The Government's major review of student financing and university funding should include a fundamental rethink of its offer to part-time students. It should ensure that part-time study is a credible option as part of lifelong learning and retraining, and that it provides access to higher education for those who are unable to study full-time.**

Alternative student finance

123. Student loans are subject to a positive real interest rate, meaning they are not Sharia compliant. A DfE White Paper, published in May 2016, notes that "this could deter some prospective students who feel unable to use interest-bearing loans for religious reasons, particularly some Muslim students, from participation in higher education."[135] The Higher Education and Research Act—which received Royal Assent in April 2017—makes provision for the introduction of a model of alternative student finance which could address this issue. When the Committee asked Jo Johnson whether alternative student finance would be available to students for the 2018–19 academic year, he said:

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130 House of Commons Library Briefing Paper, Part-time undergraduate students in England, CBP 7966, 13 June 2017

131 Open University Facts & Figures 2011/2012 and Open University Facts & Figures 2015/16

132 Open University (STL 0032) paras 6 and 7

133 Q112

134 Q110

135 Department for Education, "Success as a Knowledge Economy: Teaching Excellence, Social Mobility and Student Choice", May 2016

> We will not be able to do it by 2018–19 because it is just too complicated, but let me tell you: it is a priority. We absolutely are committed to bringing in alternative student finance and we want to see it delivered in an efficient and effective way. It has a real importance to the Government's widening participation agenda. We want to see people from all faiths and backgrounds feel that there is support to remove financial barriers to access.[136]

124. **The Committee recognises the complexities associated with the task of introducing Sharia compliant loans. The Department for Education should make use of Islamic Finance expertise both within Government and externally to ensure an alternative student finance model is introduced as soon as possible.**

The Student Loans Company

125. The Committee took evidence from HMRC on its provision of information to the Student Loans Company, following reports that thousands of people had repayments taken from their salary even after their loans had been paid off. The Committee also asked whether HMRC should take on responsibility for the administration of student loans. Jon Thompson, HMRC Chief Executive and Permanent Secretary, said the following:

> We receive information from employers much more frequently than [monthly] […] We have the ability to give that information to the Student Loans Company on a more regular basis. […] There is an ongoing project that would give them information on a more regular basis, but the question is whether they can ingest it. […] We believe that we collect 82 per cent of all student loan repayments. […] Could we do the administration of it? Probably, yes—but that's not me saying I want some more things to do.[137]

126. **It is concerning that the Student Loans Company's inability to make use of readily available data is leading thousands of graduates to overpay their student loans. The Committee notes the Government's commitment to tackling this problem in the 2017 Autumn Budget, but questions whether the April 2019 deadline for completing this work is ambitious enough. HMRC told the Committee that it could perform the administration of student loans, though it would need additional capacity in order to do so. The Government's major review should consider the case for transferring responsibility for the administration of student loans to HMRC, along with a commensurate increase in resource.**

136 Q278
137 Q132, Q133, Q134

Conclusions and recommendations

Public finances and the design of the system

1. Due to the National Accounts accounting rules, there is no impact on the deficit when student loans are issued. As such, shifting the vast majority of all higher education spending into loans that are written off in 30 years has shifted nearly all higher education spending out of the deficit. Policy decisions taken today will have no impact on the public finances for the next 30 years. Based on the current RAB charge, £6–7 billion of annual write-offs are missing from the deficit. This figure is approximately equivalent to excluding the entire NHS capital budget from the deficit. (Paragraph 27)

2. The National Accounts accounting rules stipulate that if student loans are sold off at a loss before they are written off after 30 years, there is no impact on the deficit whatsoever. The policy of selling off student loans prior to their write-off allows the Government to spend billions of pounds of public money without any negative impact on its deficit target at all, creating a huge incentive for the Government to finance higher education through loans that can be sold off. (Paragraph 28)

3. The Government concluded its first sale of income contingent student loans in December 2017, when it sold £3.5 billion of loans, writing off £1.8 billion (51 per cent) of those loans in the process. The Government plans to sell off £12 billion of loans over the next five years. If the rate of losses on these sales is maintained, billions of pounds of student loan losses will be crystallised without having any impact on the deficit. Its inclusion would increase the deficit as forecast by the Office for Budget Responsibility (OBR) by 13 per cent, from £45.5 billion to £51 billion. (Paragraph 29)

4. Political control over increasing Government expenditure is exerted through analysis of Public Sector Net Borrowing (the deficit) which the Government sets as its fiscal target. The OBR assesses whether the Government will meet this target and subsequently the majority of political debate on public spending is focused on it. As the writing off of student loans will have no impact on the deficit for the next 30 years, the large and increasing level of money spent on higher education makes no difference to whether the Government is meeting its target, and therefore escapes scrutiny. There is no effective control over the increasing fiscal cost of the student loan regime. Better oversight could be achieved through linking the Government's fiscal borrowing target to the Public Sector Net Cash Requirement, (how much money the Government actually needs to borrow). (Paragraph 30)

5. The Government is not responsible for the international accounting rules that allow the fiscal illusions within student loans to exist. However, the National Accounts accounting rules regarding financial transactions were not intended to be used for loans that, as the Government readily promotes, are designed to not be paid back in full. Loans that are intended to be written off are, in substance, a partially repayable grant rather than a loan. The ONS should re-examine its classification of student loans as financial assets—which they are in legal form—and consider whether a portion of the loan should, in substance, be classed as a grant. (Paragraph 31)

6. The Resource Accounting and Budgeting (RAB) charge is one of the most important numbers in the student loan debate. It presents, as a single figure, how much student debt the Government expects it will have to write off. Despite this, the 2016–17 Department for Education Annual report and accounts did not specify the RAB charge. **The Committee recommends that it should be published prominently in the Department for Education's Annual report and accounts, and should be publicly updated alongside any changes to the student loan repayment framework.** (Paragraph 32)

7. The Government is better able to manage an exposure to macroeconomic risks—such as low overall wage growth and low rates of employment—than the private sector. As a result, private sector investors require a large risk margin when taking on student loan assets from Government. The risk margin on the first student loans sale was, in aggregate, 51 per cent of the sale price. (Paragraph 39)

8. Exchanging student loans for cash does not improve the Government's financial position, it merely exchanges one asset for another. Despite this, the sale does reduce Public Sector Net Debt. Such a fiscal illusion does little to improve the Government's financial position and may in fact cost the taxpayer money. (Paragraph 40)

9. Such a high risk margin—and the fact that selling off the loans does not improve the Government's fiscal position—suggests the Government may be better off keeping student loans on its own balance sheet, rather than shifting the risks to the private sector and paying a large premium for doing so. (Paragraph 41)

10. Whether the sale of student loans passes the Treasury's value for money test is heavily dependent on the discount rate used to calculate the future value of student loan repayments. As with all discount rates, there is a large margin for error. The Government has chosen a different discount rate for the purposes of the sale—a rate which places a lower value on the future repayments of the loans—than that which is used in the Department for Education Accounts. **As part of its major review, the Government should consider using the same discount rate as that used in the Department for Education Accounts, as audited by the National Audit Office.** (Paragraph 42)

11. It is undisputed that writing off a significant proportion of student loan debt is a deliberate design feature of the student loan system, making a student loan unlike any other form of loan or debt. In the absence of an effective explanation of the student loan framework—including the terms and conditions students are accepting—it is inevitable that the public will see write-offs as emblematic of a failing system. The criticism of retrospective changes which increase the burden on graduates as "unfair", levelled by MoneySavingExpert and the National Union of Students, is justified. **The Government should cease this practice.** (Paragraph 49)

12. The then Universities Minister Jo Johnson stated that the higher education funding system "is delivering [its] core policy objectives", one of which is to "fairly share costs between the general taxpayer and the individual student". The fairness of the funding split is subjective; the Government should instead aim to achieve a split that is economically optimal. It is not clear how large a range of funding splits the Government would consider optimal, given that the split has swung by 10–12

percentage points since the new repayment threshold has been introduced. The Government should define what it considers to be an optimal split to give greater certainty for future public spending. (Paragraph 50)

13. The Committee welcomes the Government's planned major review of student financing and university funding. It is, however, regrettable that Jo Johnson effectively ruled out "radical change to the core architecture [of the student loan system]" in his oral evidence. The Committee hopes that Sam Gyimah, the new Minister for Higher Education, will approach the review with an open mind. The review must be objective, widely framed, and empowered to bring about any changes deemed necessary, be they radical or otherwise. (Paragraph 51)

14. In his evidence to the Committee, Lord Willetts argued for a five-year review in which the parameters of the student loan system are openly considered. There is merit in this proposal—which the Committee assumes would mean changes are made only after such reviews—not least for greater transparency. As part of its major review, the Government should analyse the benefits and drawbacks associated with introducing a pre-defined periodic review of student loan terms, and should ensure it takes account of the thoughts of students when considering the merit of this proposal. (Paragraph 52)

15. The Committee sees no justification for using RPI to calculate student loan interest rates. RPI is no longer a National Statistic and has been widely discredited. In its Autumn Budget the Government acknowledged that the use of RPI was unfair for business rates, and the Committee is unconvinced by the case put forward for its use by the then Minister, in line with the Committee's report on the Autumn Budget. The Government should abandon the use of RPI in favour of CPI to calculate student loan interest rates. (Paragraph 64)

16. The Committee recognises the importance of preventing student loans being taken out to be invested, and it is right that the interest rate should seek to prevent this. However, given that tuition fee loans—which make up significantly more than half of an average student's stock of debt on graduation—are paid by the Student Loans Company directly to the university, there is little justification for applying high interest rates to the tuition fee element of student loans while students are studying. Applying an interest rate above the level of inflation to tuition fee loans whilst the student is still at university is perceived to be a punitive measure and should be reconsidered. (Paragraph 65)

17. The Government has justified the existing level and structure of interest rates on student loans on the grounds that it is progressive. In reality, the student loan system has complex redistributive effects that are not strictly progressive. High-flying lawyers will generally pay less than teachers; but both will pay more than a graduate who does not receive a pay premium from their time in higher education. As part of its major review, the Government should re-examine the repayment system to address this anomaly so that the highest earning graduates are those that make the highest contribution . (Paragraph 66)

18. The Committee is therefore unconvinced that the interest rates currently charged on student loans can be justified on redistributive grounds. Nor has any other

persuasive explanation been provided for why student loan interest rates should exceed those prevailing in the market, the Government's own cost of borrowing, and the rate of inflation. (Paragraph 67)

19. It is incumbent on the Government to ensure that the student loan system is well explained so that prospective students and their families are able to make well informed decisions. The Government must take steps to ensure that the student loan system—and particularly the interest rate—is well explained to those that it affects. (Paragraph 68)

Is there a market in higher education?

20. In implementing the 2012 reforms, contrary to the recommendations of the Browne Review, the then Coalition Government chose to introduce a cap on tuition fees. The evidence provided to the Committee suggests this was done in the knowledge that it would create a market with no meaningful price competition. Whether price competition in the higher education sector could ever be a realistic, or desirable, prospect—even without a tuition fee cap—is debatable; the incentives for students to choose courses that command smaller tuition fees are weak. (Paragraph 79)

21. Nevertheless, the Coalition Government's expectation in advance of the 2012 reforms was that competition from new market entrants—combined with additional obligations for those universities choosing to charge above £6,000—would lead to prevailing tuition fees of around £7,500. It is overwhelmingly clear that this was a naïve assumption. Given that fees are almost universally well in excess of the level the Government intended when introducing the new fee regime, the Government should explain, and explore in its expected review, why the higher rate of fees being charged is desirable. In England, the consequences of reducing the maximum tuition fee to £7,500 or £6,000, as some have advocated, would be that the highest earning graduates pay less, and the level of funding for universities would be reduced, without either a significant increase in subsidy from the taxpayer or, more likely, the reintroduction of caps on student numbers. (Paragraph 80)

22. The current structure of the higher education market creates financial incentives for universities to recruit more students, yet the NAO has found that market incentives to achieve such expansion by improving course quality are weak. It is wrong to assume that the competition to recruit more students will be played out through competing on the basis of quality. If pursued recklessly, the aim of attracting ever greater student numbers can be damaging. The fact that university spending on marketing is increasing shows that universities can compete in ways that do not deliver any educational improvements. The market mechanisms the Government has applied to the sector are not, in and of themselves, sufficient to drive meaningful improvements in quality. (Paragraph 84)

23. If the Government is committed to creating a higher education market that functions effectively, it must take steps to improve both the quality and dissemination of information. Without adequate information, an efficiently functioning market will struggle to develop. Prospective students face the unenviable task of determining whether to participate in higher education based on increasing quantities of university marketing material coupled with a lack of proven, reliable metrics for

judging the quality of courses. It is vitally important that students are able to make informed choices about what and where to study. Such decisions are typically taken at a relatively young age, yet they carry significant long-term implications. (Paragraph 88)

24. The Committee notes that the Office for Students will be tasked with developing the Teaching Excellence Framework further by taking it to subject level. This is a sensible step, but the Committee fears the Government's efforts may be wasted if it fails to address the fact that so few students are currently making use of information that is already available. (Paragraph 89)

University finances

25. Against a backdrop of sustained reductions in public spending, the 2012 reforms saw university funding increase significantly. The sector was spared austerity. The provision of extra resource to universities sought to bring funding up to an appropriate, sustainable level that could ensure the delivery of high quality teaching outcomes. The country's universities are an asset, and are rightly admired internationally; a point that is often forgotten in public discourse. (Paragraph 98)

26. The Committee heard that universities are not awash with cash, rather, they are now being funded sustainably, with teaching now typically breaking even. This position must be maintained to ensure that we defend the UK's world-class higher education system. (Paragraph 99)

Issues for students

27. It is clear that the student loan system is complex, and has become even more so as a result of piecemeal changes to student loan terms. In conducting its major review of university funding and student financing, the Government must be mindful of the risk that additional changes lead only to more confusion. The Government should take this opportunity to simplify the system and significantly improve how it is explained. Prospective students must be able to easily comprehend the system, given the long-lasting financial implications of accessing student finance. It is the Government's responsibility to ensure that a good understanding of the system is commonplace. (Paragraph 108)

28. Student loan debt is only repaid when earnings surpass a given threshold and is written off after a defined number of years. It should not be thought of as akin to typical debt. In using the terms "loan" and "debt", the Government has made it all too easy for students and their families to think of it in this way. It is easy to imagine how the thought of accruing tens of thousands of pounds in so-called "debt" could serve as a deterrent for young people considering applying to university, and the Committee is concerned by the thought of prospective students choosing not to enter higher education due to misperceptions about the nature of student loan debt. Loan statements sent by the Student Loans Company are likely to have reinforced this troubling misconception, and must be improved to better convey the true nature of student loan repayments. (Paragraph 109)

29. The Committee welcomed the former Universities Minister's admission that alternative language would be preferable. The Government should introduce new language that better reflects the workings of the student finance system. (Paragraph 110)

30. Maintenance loans are equally, if not more, difficult than tuition fees for prospective students to understand. The Government sends mixed messages; former Universities Minister Jo Johnson told the Committee that maintenance loans are not intended to cover a student's living costs in their entirety, but that the Government is not being prescriptive about an expected parental contribution. This may mean that some students who lack access to additional sources of income are priced out of a university education. This is clearly at odds with the Government's stated aim of removing barriers to access—the Government should consider how to address this as part of its major review. (Paragraph 118)

31. The former Minister's assertion that the Government does not assume parents will contribute to living costs is directly contradicted by official Student Loans Company documentation, which states that depending on their income, parents may have to contribute towards the living costs of their student children. The assumed parental contribution will undoubtedly create financial pressure for households with multiple children at university, and the Committee is unconvinced that the maintenance loan system adequately accounts for this. The fact that parents are expected to contribute to living costs must be made much more explicit. Alternatively, if the Government maintains that it does not expect a parental contribution, Student Loans Company documentation must be corrected, and the Government must explain how university is free at the point of use for students without additional sources of income. (Paragraph 119)

32. It is vital that public debate on the issue of maintenance loans is well informed. It is deeply regrettable that the Government is still yet to publish the 2014–15 Student Income and Expenditure Survey, which will clearly be highly informative in helping the public understand students' financial circumstances. The value of the survey's findings is no doubt diminishing with the passage of time. The Committee recommends that this information is published urgently. The need for maintenance grants to be reintroduced has also been highlighted to the Committee, and the Government should assess the case for doing so as part of its major review. (Paragraph 120)

33. The Committee agrees that the sharp decline in part-time student numbers—brought about in part by the 2012 reforms—is regrettable. It is clear that the Government failed to anticipate the impact the 2012 reforms would have on part-time students. The Government's major review of student financing and university funding should include a fundamental rethink of its offer to part-time students. It should ensure that part-time study is a credible option as part of lifelong learning and retraining, and that it provides access to higher education for those who are unable to study full-time. (Paragraph 122)

34. The Committee recognises the complexities associated with the task of introducing Sharia compliant loans. The Department for Education should make use of Islamic Finance expertise both within Government and externally to ensure an alternative student finance model is introduced as soon as possible. (Paragraph 124)

35. It is concerning that the Student Loans Company's inability to make use of readily available data is leading thousands of graduates to overpay their student loans. The Committee notes the Government's commitment to tackling this problem in the 2017 Autumn Budget, but questions whether the April 2019 deadline for completing this work is ambitious enough. HMRC told the Committee that it could perform the administration of student loans, though it would need additional capacity in order to do so. The Government's major review should consider the case for transferring responsibility for the administration of student loans to HMRC, along with a commensurate increase in resource. (Paragraph 126)

Appendix 1: Graduate earnings profile methodology

Nominal pay growth for all examples is assumed to rise at an annual rate of 4.3 per cent, consistent with long-term economic determinants used in the OBR's 2017 Fiscal Sustainability Report.

RPI is assumed to be 3.0 per cent, consistent with long-term economic determinants used in the OBR's 2016 Fiscal Sustainability Report.

Civil servants: pay progression consistent with in a typical Whitehall government department for a fast-stream graduate entrant. Thereafter, promotion to Grade 6 and SCS1 is assumed.

- Years 1–4: fast-stream grade
- Years 5–9: Grade 7
- Years 10–14: Grade 6
- Years 15 onwards: SCS1

Teachers: pay consistent with steady career progression and acquisition of growing professional and leadership responsibilities.

- Years 1–6: main pay range
- Years 7–12: upper pay range, with a TLR2 payment from year 8
- Years 13 onwards: leadership pay range (broadly consistent with assistant headship)

Magic circle law firm:

- Years 1 and 2 (training contract): £44k year 1 and £49k year 2
- Years 3–14: pay tracks figures on average pay for post-qualification lawyers in 'magic circle' firms from HIA Legal 2017 Salary Guide
- Years 15+: progression to partner is assumed, but is irrelevant to the example because the loan is paid off by this point

Accountant:

- Years 1–3: pre-qualification pay based on average among large accountancy firms
- Year 4+: pay tracks average earnings (including bonus) for UK respondents to ICAEW 2015 Salary Survey

Average earnings:

- Year 1+: pay is £28,600, consistent with median gross weekly earnings of UK full-time employees

Formal minutes

Tuesday 6 February 2018

Members present:

Nicky Morgan, in the Chair

Rushanara Ali	John Mann
Stephen Hammond	Catherine McKinnell
Stewart Hosie	Wes Streeting
Mr Alister Jack	

The following declarations of interest relating to the inquiry were made:

11 October 2017

Charlie Elphicke declared a non-pecuniary interest in relation to the inquiry into Student Loans as his wife, Natalie Elphicke OBE, is a director of the Student Loans Company (and an independent external advisor to the Department of Education's audit & risk committee); and declared that he would take no further part in the inquiry.

Draft Report (*Student Loans*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 126 read and agreed to.

Resolved, That the Report be the Seventh Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 7 February at 1.30 p.m.

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 18 October 2017

Question number

Dr Helen Carasso, St Anne's College, Oxford, and **Dr Andrew McGettigan**, Author and Lecturer — Q1–91

Wednesday 13 December 2017

Rt Hon. Lord Willetts, **Lord Browne of Madingley**, and **Rt Hon. Professor John Denham** — Q92–132

Professor Janet Beer, President, Universities UK, **Amatey Doku**, Vice-President, Higher Education, National Union of Students, and **Professor Mark E Smith**, Lancaster University, Chair of the Financial Sustainability Strategy Group, Higher Education Funding Council for England — Q133–187

Tuesday 19 December 2017

Joseph Johnson MP, Minister of State for Universities, Science, Research and Innovation, and **Matt Toombs**, Director, Student Finance and Analysis, Department for Education — Q188–292

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

STL numbers are generated by the evidence processing system and so may not be complete.

1 Ajepco Ltd (STL0019)

2 Allied Health Professions Federation (STL0045)

3 Association of Colleges (STL0014)

4 Birkbeck, University of London (STL0024)

5 Chartered Society of Physiotherapy (STL0039)

6 College of Podiatry (STL0017)

7 Dr Adele Langlois (STL0041)

8 ELATT (STL0025)

9 Estelle Clarke (STL0009)

10 Estelle Clarke (STL0011)

11 Harriet Alexander and Kate Tullberg (STL0010)

12 Iain Clarke-Coast (STL0016)

13 Institute for Fiscal Studies (STL0013)

14 Leeds University Union (STL0049)

15 London South Bank University (STL0020)

16 MillionPlus (STL0018)

17 Miss Abbie Pickering (STL0008)

18 Miss Sophie Roberts (STL0044)

19 Money Advice Service (STL0042)

20 MoneySavingExpert (STL0046)

21 Mr Alan Capps (STL0036)

22 Mr Andrew Ritchie (STL0021)

23 Mr Owen Clemett (STL0006)

24 Mr Paul Moore (STL0002)

25 Mr Raj Sankreacha (STL0015)

26 Ms Isobel Bochel (STL0030)

27 National Union of Students (STL0029)

28 Nelson College London (STL0012)

29 Nicholas Bridal (STL0005)

30 Office for National Statistics (STL0048)

31 Open University (STL0032)

32 Professor Andy Green and Professor Geoff Mason (STL0031)

33 Professor Michael Larkin (STL0007)

34 Royal Statistical Society (STL0047)

35 Rt Hon. Prof John Denham (STL0028)

36 Russell Group (STL0038)

37 Sam Brook (STL0023)

38 Sutton Trust (STL0033)

39 UK Statistics Authority / Office for National Statistics (STL0027)

40 Universities UK (STL0026)

41 University and College Union (STL0043)

42 University of Central Lancashire (STL0040)

43 University of Derby (STL0037)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

Session 2017–19

First Report	Appointment of Sir Dave Ramsden as Deputy Governor for Markets and Banking at the Bank of England	HC 472
Second Report	Appointment of Professor Silvana Tenreyro to the Bank of England Monetary Policy Committee	HC 471
Third Report	The Solvency II Directive and its impact on the UK Insurance Industry	HC 324
Fourth Report	Transitional arrangements for exiting the European Union	HC 473
Fifth Report	Autumn Budget 2017	HC 600
Sixth Report	Appointment of Elisabeth Stheeman to the Financial Policy Committee	HC 758