

Treasury Select Committee

Oral evidence: Student Loans, HC 478

Wednesday 18 October 2017

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Members present: Nicky Morgan (Chair); Rushanara Ali; Stephen Hammond; Kit Malthouse; Wes Streeting.

Questions 1 - 91

Witnesses

I: Dr Helen Carasso, St Anne's College, Oxford; Dr Andrew McGettigan, Author and Lecturer.

Examination of Witnesses

Dr Helen Carasso and Dr Andrew McGettigan.

Q1 **Chair:** Good afternoon. Thank you very much to you both for coming in today to give evidence in the first of our student loan inquiry sessions. Before we start, it would be helpful if you would introduce yourselves and say your particular role and reason for being here, for the benefit of people watching, not just in the room but also on the Parliament channel.

Dr Carasso: My name is Dr Helen Carasso and I teach in the department of education at the University of Oxford. I teach higher education policy. I research higher education fees and funding. I have had a particular interest in that subject from when the fees changes came in in 2006, and have been following in great detail since then. My professional background before that was working in universities in communications, marketing and undergraduate admissions, so I have both a practical and an academic perspective on this.

Dr McGettigan: I am Andrew McGettigan. I also write and research on universities. I do so in a freelance capacity, which gives me certain advantages in terms of being able to pursue lines that certain people might not want to pursue. In recent years, I have tended to focus on accounting and the financing of student loans, but I also look at university debt and student matters. I have been in and around universities for 15 to 20 years now, and I still teach at Central Saint Martins and City Literary Institute, but that is in subjects that are not related to this inquiry.

Q2 **Chair:** Thank you both very much indeed. If questions are pretty general, please feel free to answer them if you feel it is particularly relevant to your expertise, or to defer to the other person. Then it may be that Committee members also direct particular questions to one of you. I am going to start with some of the recent announcements we have heard from the Government and the Prime Minister. The IFS has forecast that the increase in the student loan repayment threshold from £21,000 to £25,000 will cost approximately £2.3 billion a year to fund. I wondered whether this figure appears accurate.

Dr McGettigan: At the moment it is a bit difficult to tell, because it does not appear to me that this can be the end of the story. I would be expecting further announcements to be made, perhaps at the Budget.

Q3 **Chair:** What would those announcements be on? What more details are still needed?

Dr McGettigan: There is probably still a conversation about the interest rate, which has attracted a lot of public attention. I also think there are going to be questions about the control of the loan outlay, because we now have something quite confusing. The loan is a kind of voucher, but a



voucher with an uncertain subsidy. If you raise the repayment that significantly without doing anything else then the average subsidy will be 45% to 50%. That is very unclear for the public, in terms of understanding how that works. You will have a scheme where you have high graduating debt, high fees and high interest rates, and those are things that have concerned the public recently. The optics of that are a bit strange.

London Economics has independently said the cost of this would be around £2.8 billion per cohort, so there are other higher estimates of this additional cost out there, but that is a good place to start. It is a very expensive move, but one which is very difficult to present to the public as a significant saving to graduate borrowers.

Dr Carasso: The other thing to remember is that with any of these estimations there are significant assumptions about the graduate employment patterns over 30 years. We know that workforces are changing. We know there are many issues about what the graduate premia are for different courses and different subjects. We are starting to look into that. Many of the courses where the expansion is taking place are not the ones with the highest evidence of graduate premia at the moment. The devil is always in the detail in these estimates.

Q4 **Chair:** The IFS also claims that as a result of the change in the threshold the per student taxpayer contribution is higher than it would have been if we had never switched away from having £3,000 fees. Again, I wondered if you agreed with that judgment.

Dr McGettigan: We are in that ballpark, but it is a difficult question. I looked at the BIS financial accounts for the 2011-12 financial year before I came here. In that year they were putting out £6.4 billion in grants, split between grants to institutions and grants to students. There was another £1.5-1.6 billion set aside for non-repayment impairment on the student loans. That would give you a figure of £8 billion resource being put into undergraduate tuition back in 2011-12. My reading of the recent IFS note is that it is saying £7.9 billion.

Obviously there is inflation, but one thing that has changed since 2011-12 is precisely the thing that Dr Carasso has said. Projections of graduate earnings have changed quite markedly since that time. The cost of the loans that were issued in 2011-12 is now likely to be much higher than was thought back then. These kinds of comparisons are difficult to make because of the changing nature of those projections.

In answer to your question, yes, we are in that area. We have a scheme that looks as if it is pretty much the same long-run economic cost. This goes back to my point to the previous question. On that scheme the institutions received direct grants, which meant their fees could be subsidised down to £3,000. 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. Most people would



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say, "If you are going to put the subsidy into the system, do it upfront so the fees are lower, because that is what is most visible to people".

Dr Carasso: 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. The calculations of what it actually costs are multiple, complex and disputed, but there is the issue about how much we ought to be investing per student to think about.

Dr McGettigan: Yes, so there are three parties involved: the institutions, the Government and the student graduate. Most of the focus tends to be on the borrowing relationship between the student graduate and the Student Loans Company or the Government.

Q5 **Chair:** We are going to look at the impact on universities in a moment. My colleague has a question on that. On your point about the change in the graduate earnings, is that because the estimated graduate earnings are lower than they would have been when the numbers were first done? That is the impact that you were saying on the amount that gets repaid. It has changed the numbers as worked out in 2012.

Dr McGettigan: That is one of the reasons why, for example, the repayment threshold was frozen in 2015 by George Osborne. The argument was that, when that threshold was set for 2016, the promise was to uprate it in line with average earnings. When we came to 2015-16, that was much higher relative to average earnings than was anticipated. The 2012 scheme was looking more expensive than originally planned. One way of controlling the costs seemed to be using that repayment threshold in a flexible way to control repayment levels of income, a bit like setting a tax band or tax level.

Q6 **Chair:** I know colleagues are going to ask about the interest rates. If you were looking at ways to improve the scheme or to respond to public pressure, would you have started with looking at the threshold, or other parts that would make more of a difference to change public perception?

Dr McGettigan: The public perception is the issue there. Most of the public debate over the last year has been focused on the fact that the interest rates are much higher than the Government's current cost of borrowing, although the interest rates have been higher in 2012-13 and 2013-14. That is because people's habits of understanding loans and debt use the interest rate as a good way of understanding the cost of the obligation you are entering into. Optically, that would look like the thing to address. In terms of the most benefit to borrowers, the repayment threshold is the most powerful thing to use. It is just that people do not see it in the same way. There is still an issue about the interest rates, which is why I would expect that to be dealt with as well.

Q7 **Chair:** The Chancellor wrote to the Committee after he gave evidence



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last week. We did not get a chance to talk about student loans, so we wrote and asked about the estimated changes. You might have seen this. He is saying that lifting the threshold will save, I think, £360 a year. Every student earning £25,000 or more will save £360 a year. Are there other changes that could be made to help lower-earning students?

Dr Carasso: I am concerned about the fact that students from a lower income background, rather than getting a grant, get a higher loan. It is a slightly different part of the system. We end up with the people who we think are most discouraged by debt—although some of the research suggests they are not necessarily the only ones who are most discouraged by debt—as the ones who come out with the biggest debt, because we no longer give them a grant. I know that does not help the Treasury, but if we are concerned about appearances and deterrents that is an important point not to forget in this discussion.

Dr McGettigan: There is the student support package. There are various issues there, and I presume we will come to them in detail later. In terms of tweaking the loan repayment scheme and solely focusing on that, the Government can currently change the repayment threshold or the repayment rate over the threshold, so the 9%. It can change the write-off policy, so 30 years. There are other features as well, such as the interest rate, the one we have talked about. You can move all those, but it is a very complex system where moving one thing has an effect you might not anticipate.

One thing that has been lacking is that we have not had a real expression of principles behind the design. We did not really have one in 2012. The changes we have had recently are piecemeal, particularly things like changes to the discount rate and the repayment threshold, so it is not quite clear what the scheme is designed to do overall. It is not clear to me, for example, whether the real interest rate is there to encourage early repayment. You could see it as an incentive in the system, rather than as something to extract a surplus from high-earning borrowers. These kinds of principles have not been set out clearly.

There are all sorts of things you could do. You could bring the write-off much further forward. That would benefit borrowers, because you would stop repayments earlier, but it would benefit them in their 40s. Changing the repayment threshold now benefits them as far as possible all the way, unless they are earning already below the threshold. With interest rates, again you see the impact in the longer run. It is a matter of thinking through what the system is designed to do.

David Willetts was better at this than his successors. He was better at making the case for various design moves. With the raising of the repayment threshold to £21,000 from £15,000 it was quite clearly said that this is to lift the burden from those in their 20s, or those just after they graduate, and move it into their 30s. That has the consequence of generating headlines that say people will still be repaying their student loans in their 50s, but there was a clear thought behind that. I am not



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sure you could extend that to the recent move and say, "It is now going to lift the burden from people up until after 35 or 40".

Much more of the repayments that we are going to see are going to come in the second half of the loan scheme, 15 years and more after graduating. There is an argument to say that is good. It relieves pressure on youngsters. However, at the same time, the high interest rate is accruing, and that is worrying for people. Insofar as you have debt, you are in this graduate contribution scheme.

Q8 Chair: This is all fascinating and you are being very diplomatic as well. Dr Carasso, I was very interested to see the article that you wrote in *Times Higher Education* earlier on this week. There was one paragraph in particular that struck me. Again, it goes back to the principles of the system, which is about the system treating students as if they were both dependent family members and independent adults. The size of the maintenance loan and many institutional bursaries available depend on a student's family circumstances, but she is told that if she is taking out a loan she will only pay back from her own income as a working adult. Do you see that, again, as one of the issues with the system, perhaps right back to the initial design of it?

Dr Carasso: I have found when I have been doing research and talking to young applicants, who are only one group here, but the 17 or 18 year-olds, that they say, "We do not understand. You are sending us mixed messages. We cannot begin to get our head round all this". We are talking as people who spend a lot of time studying this. 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. Even if the Government do not change the rules at any stage, I cannot make rational decisions based on cost, not that cost is the only basis on which I should be making my decision. I am not in a position to do it".

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. They do not know. At the point they are applying, they have not had their family income assessed to know whether they are going to fall into the threshold where they can take extra loans or get an institutional bursary. They do not even know what they are going to be eligible for.

Dr McGettigan: It is not clear to me whether there is a preference within Government for people to access private sources of funding rather than using the student loans. I cannot tell. Certain things, like the interest rate, look like an incentive towards early repayment. However, it also presents people with quite a complex, confusing comparison to make: "Should I enter into this student loan? I have three kids coming to university. Should I remortgage?" That is not an easy judgment, because the schemes you will have are so different. People will focus on



something like the interest rate and think the mortgage is cheaper because the interest rate is lower. That is completely the wrong way to go about it. It is putting people into complex financial decisions.

The Independent Taskforce on Student Finance has been disbanded. That was a good idea. Martin Lewis used to front it. The Student Loans Company used to have a calculator on the scheme, but had to take that down. There is no real help here provided by Government for their own loan scheme to tell us what they would like people to do.

This feeds into some very simple and problematic design aspects. While studying, students face interest of RPI plus three percentage points, and once they graduate the interest rate taper comes in. I am convinced that real rate of interest for students while studying is purely there to dissuade wealthier individuals from coming in, taking their maintenance loan and investing it in a higher return investment opportunity and paying it off as soon as it falls due, thereby scalping the Student Loans Company a little bit. That was never a huge problem, although it was there. Instead, you have this problem of people saying, "Why am I being charged 6% interest while I am a student?" Optically, it is terrible.

Q9 Wes Streeting: One of our jobs during this inquiry is to unpick the complexity and opacity around the impact of the student loans book and the financing system on public finances. Before I turn to that, I will pick up on some of the Chair's questioning around the principles behind the scheme. At the 2015 general election, Labour had a pledge to reduce headline tuition fees to £6,000 a year. The current Government are talking about freezing student fees at their current cap. Which cohort of graduates would benefit from those two policies?

Dr McGettigan: It is a side point, but it might be worth saying just to indicate how confused they were. One of the ways in which Labour was going to pay for that policy was by changing the interest rate to RPI up to 4%, so it was going to increase the interest rate taper. No one would consider that today because it looks so bad. Then your question becomes more complicated.

Presumably with reducing the fee to £6,000, there was also going to be a scheme to restore teaching grants to institutions, although I never saw a worked out policy of that.

Wes Streeting: Details, details.

Dr McGettigan: The case is on the one hand, as students, what resources were going into the educational experience, and as graduates how much debt you graduated with, what was its interest rate and where was the repayment threshold.

This is a more general point: 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. 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.

Wes Streeting: Yes, that is right.

Dr McGettigan: This is a general problem with the scheme. The tuition fee cannot signal like a price once you have a large subsidy built into the 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.

Wes Streeting: Especially when the price is the same at pretty much every institution on every course as well.

Dr McGettigan: Yes, but that is why it 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.

It almost makes no sense to choose the lower price. Some universities experimented with lower prices, as I think Derby did for a bit. London Metropolitan tried to hold it at £6,000 for several years. They have now all gone to where the rest are. That is completely rational. For all the reasons that I have said, the consumer should not be choosing the cheaper option, given the loan available.

Wes Streeting: I agree.

Dr Carasso: There were some universities that, under the £3,000 fees, operated a cashback model. They charged £3,000 because they believed in the price signalling, the premium pricing, but then gave every single student £1,000 back. They stopped doing that and just charged the £3,000 fee straight up, but they were trying somehow to use this price as a signal.

Dr McGettigan: That is also one of the reasons why access agreements were not allowed to offer cashback as part of their various measures. There were various schemes used to try to get round that.

Q10 **Wes Streeting:** There were means tested bursaries in access



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agreements. Let us take all things being equal in terms of repayment, terms and conditions and interest rates. It is the case, is it not, that if you freeze the maximum fee charged at the present level, or you reduce the fee cap, the only people who would really benefit in cash terms would be the highest earning graduates? Their total lifetime contribution would be lower.

Dr McGettigan: Yes, and the Treasury.

- Q11 **Wes Streeting:** Yes, and the Treasury, assuming that it is not providing the same unit of resource to universities. Arguably, you could say that the winners in that scenario would be highest-earning graduates paying less over their lifetime and students in general, because their institutions have less to spend on teaching and learning.

I now want to get into the murky world of how this whole system works in terms of public finances. I am going to focus on you, Andrew McGettigan, for this round of questions. Do not worry, Helen, I have another round for you later on in the session if we have time for it.

I really enjoy your blog. I hope that in the session this afternoon we can try to make it easily understandable to people who are not as obsessed about this as we are. Since the 2012 reforms to student loans, the vast majority of spending on higher education is not counted in the deficit. Could you explain why, and why the write-offs for student loans do not appear to count towards the deficit either?

Dr McGettigan: What happens in national accounts is, because you are creating a loan, creating a financial asset, the loan outlay is not counted as expenditure, and loan repayments are not counted as income. It is because they are not classified as income and expenditure that they do not appear in measures of income and expenditure, like the deficit, whether it is the public sector net borrowing, the current balance or things like this. It is because loan outlay and repayments have been categorised differently to recognise the fact that it is not just spending and it is not tax income. You have created a financial asset, and so it needs to somehow be recognised differently. The way of doing that is to classify them differently.

- Q12 **Kit Malthouse:** Sorry to interrupt. What about the coupon, the interest element? Capital out, capital in is what you say, but there is an interest element here. Sorry, Wes.

Wes Streeting: No, that is a good question.

Dr McGettigan: It relates also to your question about the write-off, because write-offs do count as expenditure, but they count as capital expenditure. Write-offs occur annually through death, disability, bad debts or whatever, but also the policy write-off, which will start happening significantly for the pre-2012 loans in 10 or 15 years.

- Q13 **Kit Malthouse:** There must be a revenue effect of the write-off, so where is the other side of the entry?



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Dr McGettigan: The two entries work like this. The other side of the entry is interest accruing. Interest receivable counts as income. Every year you go along you score the capitalised interest as income, and that scores in the deficit. That is a positive every year until you make the write-off, when you score the balance you have written off on the accounts as the expenditure item. Those two netted together are the equivalent of the loss on loans, because loans plus interest is the same as outstanding balance plus repayments.

Q14 **Kit Malthouse:** So they create a loan that is actually the capital plus the interest. It is a gross loan, not a net loan.

Dr McGettigan: Interest is accruing, and in the department's accounts that counts as new lending every year. Effectively, you have lent out money. The problem is that when I say you are recording interest receivable I mean that very strictly. We are recording the interest accruing, even if we do not think that interest is ever likely to be repaid. For cash repayments, there is no distinction made as to whether it is against principal or against interest, and it is not counted as income at all.

The normal way of thinking about this would be "My loss on loans is loan outlay minus repayments received", in cash terms. However, because of the accounting identity, that is exactly the same as outstanding balance written off minus interest accruing. I have put this in a note that I submitted.

Kit Malthouse: I will have a look, sorry.

Dr McGettigan: This is an unusual solution, because it means that for all the years until the write-off you are recording the interest accruing as income. That flatters the deficit very nicely. It is £3 billion this year, and it was projected to be £7 billion by the end of the Parliament. As income that you could net against the deficit, it is a benefit to the deficit score.

The write-offs are going to be big, because all of that interest is not going to be repaid. When they occur, that is all undone and you have closed the accounts, so you know what your loss is. You only get that showing up right at the end when you close the accounts.

Q15 **Wes Streeting:** Kit's questions absolutely go to the heart of some of this. This is a great accounting wheeze that works for everyone. There is more cash readily available to spend on universities than would otherwise be the case if we were accounting for it as traditional expenditure. Your answer suggests that we are making the deficit appear better.

Dr McGettigan: We are flattering it. The OBR calls it a fiscal illusion.

Q16 **Kit Malthouse:** Are you saying it is also a form of internal borrowing?

Dr McGettigan: The presentation of the fiscal position looks better than it truly is. This is fine for a normal loan. If it is a loan that you are



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expecting to be repaid, the surplus you are making on the loan in cash terms is the interest accruing. If there are bad debts and you have to write them off, you might have made a loss or not. It works okay for the pre-2012 loans, because the interest on those is very low. It is 1.25% nominal at the moment. There is a very tiny bit of interest being scored as income. Then, when the write-offs come, a lot more of those are going to be repaid than for the post-2012 loans. In that case, this looks like a reasonable way of reflecting the fact that loans are different from grants expenditure.

The problem is, with the 2012 loans now, this is all cockamamie. The interest accruing is much higher than the previous scheme. It looks like it is much higher than the cost of the borrowing that we are using to create the loans in the first place, and we know we are going to have these enormous write-offs. This write-off is in nominal terms. Whatever it says on the balance in 2045, when you write off large amounts of loans, that scores in the deficit.

However, before we get too wrought with ourselves, none of this has any cash implications. I know the normal story is there is the deficit, the debt, and the deficit adds to the stock of debt, but in this case that is not quite true. Although they affect the score of the deficit, this is not what is driving any change in public sector net debt. That is driven, in this case, by the public sector net cash requirement, where loan outlays as cash and repayments as cash do count. It is the shortfall between the two that adds to PSND.

Q17 Wes Streeting: In terms of accounting, talk us through the RAB charge. Sorry, I am making you work hard this afternoon. The Education Secretary will see, when she is looking at her departmental budget, a line of expenditure there, the RAB charge, to make an annual departmental contribution towards debt write-off. Is that the correct way of looking at it?

Dr McGettigan: The first thing to say is that the national account is cash in, cash out. It works completely separately. We have the departmental accounts, which are an accruals accounting system. That means you have to record commitments when you make them. The loss on the loans is a known commitment, so it has to be recorded when it is made.

This is where budgetary control comes in. The RAB charge is also a RAB allocation. The DfE is now given allocations at a spending review to cover this in the future years, and then you have to work out the charge. If you are saying "Where is the control in this system?", you see it more at the level of departmental accounts. The two systems are running in parallel.

The RAB charge is the recognition that the loans you are issuing are impaired. They are not worth the face value. You are issuing £10 billion. Everyone will have a loan statement saying they have borrowed different amounts, all adding up to that £10 billion, but you know when you have



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issued them you are not expecting to get the equivalent of that £10 billion back.

On last year's accounts the RAB charge was thought to be about 29%. The idea then is the repayments you are going to get back are the equivalent of 71p for every £1 you have lent. You know you are making a loss, and that is the impairment, but it is ring-fenced, non-cash and sits in its own special part of the resource departmental expenditure limit. You cannot use that allocation to cover anything else. It is solely preserved for loans.

- Q18 Wes Streeting:** The practical limitation is that the RAB charge sits there in the departmental accounts, and the Chair probably knows this better than any of the rest of us round the table. That is, on the books, an area of expenditure that the Education Secretary otherwise might have chosen to spend but cannot spend on, say, early years or the schools budget.

Dr McGettigan: They cannot spend it on anything else. It is purely to do with the loans. It is the estimated impairment on the loans issued that year.

Chair: I thought I would just say, for the record, that it was not my responsibility when I was in Education. It was in BIS.

Wes Streeting: No, that is right. It was in BIS.

I want to get some real clarity around this. The aim of all my questions is to work out, at different points down the line, the practical implications of the way we chose to account for the student loans book. You said the RAB charge at present is 29%. As a result of the decisions that have been announced recently, the combined impact of the changes that the Prime Minister and others alluded to at the Conservative Party conference would be to increase the RAB charge up to around 45%. That is a significant uplift. That was the view of the IFS, and it would be interesting to see what the OBR thinks, incidentally. My question following from that is this: if the RAB charge is going to increase to that extent, does that mean that Justine Greening is going to see a reduction in her departmental budget to spend on other areas?

Dr McGettigan: This is a policy change. What you would expect is they would be given the budget to deal with the policy change. That is why I was careful to say at the beginning it is an allocation and a charge. You will have to go back and review the allocations that were made in 2016.

- Q19 Wes Streeting:** If the Treasury did not give the Education Department a larger budget, presumably that would have an impact on other areas of the department's spending, as they need to balance the books.

Dr McGettigan: There has to be a fiscal negotiation there, has there not? There are various measures in place to deal with what happens if you have been allocated something and then it turns out in a year that you are going to need more than you thought. This is to do with things like the target impairment, which I have to admit I am not sure works in



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the way it did work under George Osborne. There seem to have been some quite significant changes in, when there is upwards pressure on the budget, how it gets resolved.

This is a wholesale policy change, so what you would expect at the Budget is a series of announcements. Then when you look in the supplementary materials at who has been allocated what, you would expect to see additional RDEL non-cash, probably included under depreciation, given to the Department for Education to deal with this change in impairment on loans.

- Q20 Wes Streeting:** I will fast forward to my final question, because I am conscious that, between Kit and me, we have hogged quite a lot of time. Fast-forwarding 25 years, when the first round of significant debt write-offs kick in, the 30-year repayment threshold limit will be kicking in and debts will be written off. Is there a big problem for the Chancellor or the Chief Secretary that year? What is the practical impact of debt write-off after 30 years on the public finances?

Dr McGettigan: The headline statistics will look worse, but there are no cash implications at that point, because the write-off will count as capital expenditure. It is reflecting the fact that you now know what the loss is. All the cash transactions that you use to calculate that loss already happened. The cash on the loans was issued way back in two thousand and whenever, and then repayments have come in over the course of the preceding decades. You are just finally totting it up and announcing it through the statistics.

This is sometimes misunderstood that there is a black hole in the finances or this, that and the other. As soon as it looks like that, you will start dealing with it well in advance. The repayment threshold freeze in 2015 would be one example of this. The RAB charge you are prepared to support diverges from what is needed and you have to make decisions. The student loans are not self-financing. They lose money, so money has to come from elsewhere to fund them. The issue to think about is the repayment flow over the next few decades. If that starts looking significantly smaller than you were anticipating, you are not going to wait until 2045, 2046 or 2047 to deal with it.

Alternatively, and maybe this is what happened, there is a wholesale change of heart in the Treasury and they are now prepared to support that 45% and 50% RAB charge. Perhaps they are happy now with that lower repayment threshold. It is always going to be a political decision for the Treasury at the time to decide, "Are we happy with that repayment flow?" If somebody picks up the write-off in 2045, the deficit will look very bad from that. Deficits in subsequent years will look bad, but if you choose the current balance as your deficit measure it will not appear at all, because it is capital expenditure. There will be various ways of managing this.



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The question to think about is what you are using your headline statistics to tell yourself and others about the health of the economy. We will probably recognise at that point that that write-off recognises decisions that were made a long time in the past.

Q21 Wes Streeting: Is there anything you would change in the presentation of all this, in terms of how we present it in the accounts? Are we totally bound by international accounting rules so there is no scope for tinkering with this?

Dr McGettigan: The thing you can choose is whether to use the current balance or the public sector net borrowing as your measure of the deficit when you talk to the public. Which one do you target in your fiscal mandate? That is one way of thinking about it. This goes back to my answer to the previous question. 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.

You can push that a little bit. If the interest rate is not touched, you might say that is one way, but that is purely a presentation issue. You are telling the public you are trying to get the deficit down, and it turns out that you are benefiting from £3 billion, £4 billion, £5 billion, £7 billion of interest that you are recording as income that you are never going to have repaid. You cannot legislate for that, in some senses. There are always going to be ways to move these things about to your best advantage.

The main issue is to have Committees like this holding them to account, knowing that there are these distortions and illusions in there. Student loans are *sui generis*. They have their own treatment, but as they get bigger and bigger they are going to have more of these distorting effects on the general headline statistics. Public sector net debt is the other obvious one.

Chair: I am conscious of time and moving on. This is the nub of the issue, and that is why the inquiry is asking the questions.

Q22 Kit Malthouse: Just so I am clear, the RAB charge is charged every year and it sits on the departmental balance sheet waiting for its future use against the outstanding balance of loans.

Dr McGettigan: Yes, you use it to create an impairment.

Q23 Kit Malthouse: It is bad-debt provision.

Dr McGettigan: You have a face value of loans.

Q24 Kit Malthouse: The Department for Education balance sheet must therefore have an accumulating balance of these write-offs.



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Dr McGettigan: Yes, and you can see that on the first page of the briefing I provided, which is an extract from the DfE's accounts. It shows precisely this.

Q25 **Kit Malthouse:** What is the current balance?

Dr McGettigan: On all English loans?

Kit Malthouse: Yes.

Dr McGettigan: For all English loans, the outstanding face value is £89 billion, and the fair value, the carrying value, is £61 billion. There is a difference of £28 billion.

Q26 **Kit Malthouse:** What is the RAB balance?

Dr McGettigan: The difference between those two, so the £28 billion, is the impairment. Each year's RAB contributes.

Q27 **Kit Malthouse:** It tops it up?

Dr McGettigan: It tops it up, but then that RAB is utilised through various things: interest rate subsidy, write-offs, amortisation.

Kit Malthouse: I have the numbers now.

Dr McGettigan: You can see each of the aspects of this working through. The top of that diagram shows you the opening face value of the loan book, the value of the opening repayments, then what happens in year and then comes back between the two.

Kit Malthouse: Brilliant. Paul Daniels would be proud.

Chair: You can see who the former accountant on the Committee is. Now he is happy. He has the numbers.

Q28 **Rushanara Ali:** I have a question about mortgages, and how loans are treated when mortgages are allocated. I wonder if either of you know, under the new system, whether mortgage companies take into account the student loan element when they are deciding how much a borrower can take out for a mortgage for a home. Has that changed? Is it excluded or is it still a part?

Dr McGettigan: I do not believe it has changed. In my understanding, there was a lot of lobbying around this back in 2011-12. The agreement reached was that the stock of debt would not be counted, so they would not look at your outstanding student loan balance and say, "That is a debt you have". The other aspect of it is student loans affect your disposable income, so the impact on your disposable income would be taken into account in a mortgage application.

There are a lot of efforts to try to get this treated differently. It is not like a debt in some ways. You will hear people like Martin Lewis say we should not even call it a loan and a debt. In practical terms, for mortgage lenders and other kinds of lenders like that, that is when you want to say,



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"It is a graduate contribution scheme". What is happening is 9% over the threshold is coming out of gross income every year, so the graduates with a loan debt will have lower disposable income.

Q29 Rushanara Ali: So the substance of the experience is that, if the mortgage companies are looking at your disposable income, they are, in effect, taking into account—

Dr McGettigan: Yes, because it is an outgoing, but they should not be saying, "You have £90,000 of student debt and you have £40,000 of student debt; therefore we are prepared to lend you £20,000 and not you £20,000".

Q30 Rushanara Ali: But the amount you can borrow will be lower?

Dr McGettigan: They are both repaying 9% over £25,000, so the impact on their disposable income should be the same if they have £15,000 or £150,000. That is what the expectation is here, that the company knows that the student loan debt is not really debt in that sense.

Q31 Rushanara Ali: Are you confident that mortgage companies know that?

Dr McGettigan: I am not confident about that at all. I am confident that there was a lot of lobbying around this, and I know that Ministers met with banks and things to get this down.

Rushanara Ali: It would be really helpful to get some clarification. I do not know whether you would be placed to do that.

Chair: We can get some clarification from whoever it is that can give us an assurance or not.

Q32 Rushanara Ali: We can get to the bottom of whether the lobbying has been successful or not. You have covered some of this already, so apologies if there is repetition. Would you agree or not with the IFS that universities have experienced a significant increase in per pupil funding since 2012?

Dr McGettigan: Yes, the English university sector has more income since 2012, because the fees were higher. That more than covered the loss from the institutional grant. That is uneven. There are some institutions that do not have more income than before because they have lost students. There is also the impact of the market here. In terms of the sector overall, there is more.

Q33 Rushanara Ali: There has been. Is there a discrepancy between post-92 and pre-92 universities?

Dr McGettigan: You would have to look at it case by case. There are some really varied impacts. Also, you might want to look at London in particular for examples of institutions that have lost student numbers since 2012, for example London Metropolitan. Kingston has had a recent decline in numbers, as has Westminster. It is one of these things where you have to go case by case. It is very hard to make generalisations.



Q34 **Rushanara Ali:** Earlier on you were saying, if the fees are £9,000, would you go to UCL, LSE, London Met or whatever? They are making those choices.

Dr McGettigan: There are other factors. London Met's numbers are almost one-third of what they were before, in 2010. There is a complicated story there. Kingston, if I am right, tried to set its UCAS tariff a bit too high. There are other things going on at Westminster. I would not particularly want to talk about those in this setting. The sector was spared austerity, but there have been market effects, so not every university has the same income that it would have had. They have been exposed to more changes.

Q35 **Rushanara Ali:** In your view was that an unintended or intended consequence on the side of the Government? Was it intended?

Dr McGettigan: The intention of bring in market competition was, yes. One of the signs of market competition would be that the institution—

Rushanara Ali: I mean the increase in institutions receiving more income.

Dr McGettigan: Yes. This was why the university management were so keen on the scheme that was brought in.

Q36 **Rushanara Ali:** Do you feel that the Government were disingenuous—I do not want to use pejorative words, but it is the word that came to mind—in expecting the numbers to go up to £7,500 instead of £9,000 per student?

Dr Carasso: Certainly the behaviours that we had seen under the previous increase were that those universities who had tested out lower fees, as we both referred to, very quickly found that this issue of premium pricing and price signalling meant that it was a disadvantage to charge anything other than the highest fee. That was in terms of what applicants thought. There was some hope when the fee was £9,000 that that would not apply, but very quickly the same principles seem to have kicked in, in terms of applicants' perceptions and the university's responses to them.

Q37 **Rushanara Ali:** The public narrative we got at the time was that the Government expected universities not to hike up the increase. This seems to suggest that the information that they had and that was available would point to a different direction. Was that doublespeak by the Government at the time?

Dr McGettigan: I do not think it was doublespeak. There are two things we have not mentioned in this context around the issue of competition. One is they thought there was a mechanism for limiting how far beyond the £6,000 mark universities could go. That was if you are to charge over £6,000 you have to enter into an access agreement with offer. The Ministers at the time thought there was a mechanism there to push back against universities setting fees too far beyond that, and there was not.



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The other thing was anticipation of a whole new level of competition coming from alternative providers. They were allowed into the market. There are lots of them in Whitechapel and other parts of London. They would be offering the kinds of subjects, like business and law, that they could run for under £6,000 a year. There would be a price competition at that level. There would be a different body of institutions coming into the market and challenging those established universities that were trying to charge £9,000.

That did not work, because those providers, by and large, went to whole new constituencies of people who were not previously applying to university. The National Audit Office has brought out today its follow-up report on what was going on in the years between 2010 and 2015 in the alternative higher education market.

Q38 **Rushanara Ali:** There was eligibility for the loans there.

Dr McGettigan: Yes. The students going to those institutions could previously have borrowed loans up to £3,000. At the same time as the £9,000 fee came in, the upper loan limit for students at alternative providers went up to £6,000. The feeling was that you could run a degree in business or law for £4,500 or £5,000, make a bit of profit, but offer something that would undercut the established provision. Therefore, there would be a downwards pressure on prices elsewhere. That did not happen at all, because by and large the most aggressively expanding of those institutions did not compete for the kind of students who were applying to universities.

Q39 **Rushanara Ali:** Universities are being guaranteed £27,000 in fee income for every student that enrolls, regardless of the cost. In your view, do universities have too much of an incentive to offer a proliferation of cheap-to-run courses that can generate a surplus?

Dr Carasso: I do not like using the word “consumer” for students, because they are very much more than consumers, but they are much more aware of the level of service and facilities that they should be receiving to enable them to study to achieve a good degree. That pressure certainly helps to make sure that people are receiving a good educational experience for their fees.

One of the criteria on which universities are judged in things like league tables is their entry tariffs. If you expand, you are almost inevitably going to be taking students with lower qualifications. I have certainly been in discussions in universities at clearing and times like that when they say, “We could take lots more people in, but it will bring our tariff down. It will lower our position on league tables. It will make us less attractive to the more qualified students that we want”.

Q40 **Rushanara Ali:** It is not happening. In your view, as a result of those points there is not a proliferation. Is that what you are saying?

Dr Carasso: There is growth across a range of subjects.



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Q41 Rushanara Ali: What is the answer to my question on lower cost courses?

Dr McGettigan: It is a bit like my answer to the previous one. You have to look at this case by case. There is an incentive in the system. The classroom subjects, for example social sciences, arts, humanities, law, business, anything you teach in a lecture in a classroom, 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. You would think there is a significant surplus to be made on the old scheme.

There are particular institutions where you can see expansion, particularly in business, which has always been in high demand. Perhaps if you are at the top end in the Russell Group, these concerns about lowering tariffs may not apply in something like business because there is just so much demand. You can try to expand those. There are particular institutions where this has clearly happened. At the same time, you have all these other additional costs that are coming in under the new scheme, for example access agreements.

The issue then is really the question of cross-subsidy. How far are the fees attached to those students cross-subsidising other activities of the university? That is another question.

Dr Carasso: There is also the question of marginal costs. There will be a point at which your classroom is not full and you can add five more business students. If you have to start running two streams because you simply do not have the resources it becomes a different issue.

Dr McGettigan: I think you have seen the story about Surrey having to use the local cinema for lecture theatres this year. These are difficult decisions. That would be the place to focus that question. There is not much margin in most of the other subjects. Inflation has certainly had its effect. Things like having to pay for access agreements out of the additional fee over £6,000 are also holding down on any surplus. For the classroom subjects, there is an incentive to recruit more of those students.

Q42 Rushanara Ali: I wanted to come on to access agreements. Do you feel those access agreements linked to higher fees are working? What have been the positive impacts of those access agreements?

Dr Carasso: There is a lot more understanding now of what does and does not work within access agreements. There is a strong incentive to move away from simply giving cash bursaries to students. I was involved in some research where we set up a model for universities to use, to look at impacts of the cash bursaries that they provided on the type of students who were coming and on completion rates.



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Increasingly now, universities have been encouraged and expected not to increase that part of funding, but to put extra money into moves to support widening participation. That includes raising aspirations in schools, but also increasing completion rates, supporting the destinations that young people or graduates move on to. That amount of money is growing as a proportion and is a proportion of a larger sum.

- Q43 **Rushanara Ali:** But it is still patchy, is it not, the focus on helping students who manage to get into university, particularly working class students and ethnic minority students who manage to get into Russell Group universities? There are then issues around dropout and the employment outcomes. As you will have seen from last week's report from the diversity audit, you are twice as likely to be unemployed as a graduate if you are black or Asian. There are similar trends on white working class groups.

What is your assessment overall of the impact of access agreements? What else should happen to strengthen those, particularly the outcomes in terms of retention of numbers of students from those particular backgrounds once they are in universities where they struggle, as well as employment outcomes? Those are a scandal, frankly. There is an issue around workplace behaviour and what they do, but there is an issue around what universities do to prepare working class students for the world of work.

Chair: Can you keep answers brief? We are particularly looking at the finances today.

Rushanara Ali: The agreements are relevant too.

Chair: The agreements are relevant, but the way universities interpret them and what has happened is probably something we will pick up in another evidence session. Please do answer.

Dr Carasso: There is a very clear direction from the Office for Fair Access. Looking at its projections for how spend on access agreements is going to grow, the move is towards particularly this category of what it calls student success and progression. Just looking at these figures here, the spending is almost doubling between 2015-16 and 2021-22. At the same time, some of the cash bursaries are going down. I absolutely agree that there are people who have been more effective in what they have been doing. There is a lot of sharing of knowledge, experience, good practice going on in the sector.

- Q44 **Rushanara Ali:** Are there particular ones that you could name that you were particularly impressed by?

Dr Carasso: There are examples. I have the most recent OFFA report here. It talks about, for example, Southampton Solent working with white working class males. Many universities are doing work with pre-16 year olds. I know LSE takes an approach of saying you have to work with the same students over a number of years. You cannot just go in and do one



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intervention and then move out. It established very long-term links with particular schools and colleagues in its area.

Q45 **Kit Malthouse:** Have we effectively created a time-limited graduate tax?

Dr McGettigan: Yes, and also one that you can pursue if the graduate goes overseas.

Q46 **Kit Malthouse:** Interestingly, apparently at party conference Jo Johnson referred to it as a time-limited contribution. Is that where we are?

Dr McGettigan: Your repayments first fall due the April after you leave university. Then there are 30 years of repayments.

Q47 **Kit Malthouse:** Instead of all this complicated accounting backwards and forwards, write-offs and all the rest of it, would it not be easier to have a time limited graduate tax?

Dr Carasso: 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. It would be easier to present in certain terms to applicants. It would be very clear, but it might feel like penalty if you say, "You are going to pay higher tax because you are a graduate". These are some of the perverse incentives and signalling that we really do not know about.

Q48 **Kit Malthouse:** Do you not think student loans feel like a penalty?

Dr Carasso: Student loans feel like—

Kit Malthouse: A favour.

Dr Carasso: You are borrowing and you are paying back. Why should I pay higher tax because I am a graduate? This is not necessarily the reason not to do anything, but there are no examples of a straightforward graduate tax that I am aware of in any major economy as a model for paying for higher education.

Dr McGettigan: There are two or three key reasons. First, you cannot pursue them outside the UK tax jurisdiction. That is the advantage of the loan in the first sense. Secondly, what is the definition of the graduate? It is much easier to define people you have lent money to. How would the graduate tax work? Would there be incentives for people to drop out just before they technically graduated? Would there be an incentive not to turn up to the graduation ceremony? These sound like silly points, but there is a problem with the precise legal definition.

Historically, we have not had a huge problem with emigration. Other countries, like New Zealand and Australia, have. The income contingent repayment loan scheme deals with precisely this problem. If somebody decided to either study abroad and come back, or study here and leave, they would have escaped it. It is a problem in that aspect.



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The thing I would also add, which sometimes is not clear, is that every proposal I have seen for a graduate tax to replace tuition fees still has people borrowing for maintenance support. Then you have a problem with concurrent repayment. You are going to have people repaying their maintenance loan and paying a graduate tax at the same time. If you were to do something like that you would have the inverse of what we were talking about before. It would put an additional repayment burden on recent graduates, because they would be having their 9% but they would also be having whatever percentage graduate tax.

Q49 Kit Malthouse: Presumably the other issue is how you would deal with the subsidy. Unless you set the graduate tax at a full recovery rate within the time—

Dr McGettigan: It is just expenditure then. Because you do not have the loan structure, we go back to basic income and expenditure accounting. The money you give to the universities to teach those graduates is current expenditure. The money that comes in is income. You have no benefits from the accounting in terms of some of the presentation we looked at. Your deficit gets hit straight away because your initial outlay is huge. Let us say you tried to mimic the repayment structure of the student loan; those repayments are going to be coming in mostly 15, 20 or 25 years away, when people are at the mature end of their careers. Until then your deficit is going to be hammered.

Q50 Kit Malthouse: You would carry a massive deficit.

Dr McGettigan: Yes. The accounting is one of the main reasons that the Treasury is not interested in it. In terms of graduates, it looks like you have the two things: the maintenance loan and the graduate tax. There is also the problem of defining what a graduate is, instead of having the clear contractual relationship: "We have advanced you money and you owe it back to us on these terms". There is no issue there of who does or does not owe the money.

Q51 Kit Malthouse: Yes, I understand. Notwithstanding the accounting ballet dance that we are doing throughout this whole thing, you think there are probably more problems with the practicalities of graduate tax than there are with this system.

Dr Carasso: To me, looking at universities, the big one seems to be that you are completely untying the cost and the charge to the students, as I understand it, from resources available to universities. You would go back to some sort of teaching grant model. As we know from periods when real-terms teaching grants slipped something like 50% over 15 years during the 80s and 90s, you have no guarantee that you are going to be resourcing universities to the quality and the standard that you want.

Q52 Kit Malthouse: They would be back to competing with hospitals, the police, the army and all the rest of it.

Dr Carasso: Absolutely, and vulnerable in that way.



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Dr McGettigan: Universities do not want it, for that reason. The other thing to say is, if you are trying to get some kind of market, in effect, in higher education, if you take out the fee, the graduate tax is blanket. Whether you went to that university or that university, you are a graduate. All the reforms of the last 15 years have been moving towards more of a market mechanism, which we kind of have now. It is not clear it works, for various reasons, but if you went to the graduate tax you would have abandoned that.

The main reason we have this peculiar income contingent loan design is to mimic the distribution curve of a progressive proportionate graduate tax, without those disadvantages. The more you try and deal with the disadvantages you talk about, you end up with something like the income contingent repayment, except you do not have something called debt. This is the big presentational public issue. You would have this very similar repayment structure but you would not have a balance that was accruing interest.

The other thing to compare, and I am not an expert on this, and I have not seen the more recent details, is what is happening with the sharia-compliant student loans. They will have to mimic the repayment structure of the current scheme to some extent, because otherwise you cannot stop everybody going for the sharia-compliant option, as far as I can tell. However, that has to have the interest obscured.

Q53 **Kit Malthouse:** It has to be a profit share.

Dr McGettigan: Yes, but you have to mimic the repayment structure. That may be where there are lessons to learn for something that deals with that particular problem of debt interest.

Dr Carasso: If you went to a graduate tax, it is also not clear where the funds that are used for access agreements would come from. That is a substantial pot of money used for very specific purposes. Where would that come from? There are a number of things.

Q54 **Kit Malthouse:** It would chuck it all straight back into the Treasury pot, effectively, for competition.

Dr Carasso: Yes.

Q55 **Kit Malthouse:** I understand. The other area I wanted to ask you about was sale of the portfolio. Is it a good idea or a bad idea? We have done one already, right? It was £160 million, so a tiny little one, of the mortgage-style loans, which is an easy thing to do.

Dr McGettigan: We have sold all the mortgage-style loans that were issued to those who started before 1998. Two of those sales happened in the late 90s. The final sale happened in 2013. We made a profit on those, because that is a completely different structure. Those loans were not collected through PAYE. You had to be chased by the Student Loans Company. The private sector, which was largely a collaboration between



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a debt collector and a bank, decided they had more efficient debt collection mechanisms than the Student Loans Company, so they were prepared to offer a price that was above the Government's valuation. It was something like a £12 million profit on English loans.

What is being proposed at the moment is nothing like that. Now we are looking at a securitisation, with various flavours on offer. The first thing is that it goes back to these present issues around the accounting. One of the main focuses of the loan sale is to change what PSND looks like. At the moment, the liability the Government are undertaking to create the loans, the borrowing they do to create the loans, is liability that counts in public sector net debt, but the loans created, which are an asset to Government, are illiquid. Therefore, they are not included in the public sector net debt calculation.

The compositional effect of that is you get the liability but you do not get the asset that nets. Already the Government's balance sheet is being obscured by this compositional thing. You can see that, if you could swap the student loan for the equivalent cash, you would get the benefit from it overnight, or you can use that cash for other purposes, and therefore do not need to borrow more gilts or something like that. A large part of the drive for the sale is to change that PSND figure. These loans are going to increase markedly over the next few years.

Q56 **Kit Malthouse:** In the long term, you are going to be selling to somebody whose cost of funds is higher than yours. You are going to have to crystallise part of your accumulated RAB charge, because they are going to buy at a discount to book.

Dr McGettigan: They are going to offer you a price lower than your fair value.

Q57 **Kit Malthouse:** Yes, so there is a discount to book. You have taken that hit already in the DfE accounts through your RAB charge, which is accumulating, so you bring forward—

Dr McGettigan: That is not in the national accounts, though. That is only in the departmental accounts.

Q58 **Kit Malthouse:** Do the departmental accounts not form part of the national accounts?

Dr McGettigan: No, they are two parallel processes.

Q59 **Kit Malthouse:** Where does the RAB charge appear in the national accounts?

Dr McGettigan: It does not. The only thing that appears in the national accounts is the write-off at the end. That is the capital expenditure. You can say, "That looks a bit like the RAB charge", but what is written off is the outstanding nominal balance.

Q60 **Kit Malthouse:** What is the other side of the write-off? If they have a



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write-off to the national account's revenue account, what are they writing off on the balance sheet?

Dr McGettigan: They do write that off on the balance sheet. That is a balance sheet measure, not an income-expenditure measure.

Q61 **Kit Malthouse:** Yes, but when you write something off on the balance sheet it has to have a revenue account. It is a dead loss. It counts as expenditure.

Dr McGettigan: But it is not appearing in public sector net debt. This is the issue here. It is always on the balance sheet, but it is whether it is being captured by the headline statistics that are used to form part of the fiscal mandate.

Q62 **Kit Malthouse:** I have a receivable on my balance sheet of £100 billion, and I decide I have only £50 billion to receive. I have to write off £50 billion, so I debit my credit on the balance sheet, and I have got a debit that has to go to my profit and loss account in normal circumstances. Where does it go?

Dr McGettigan: In the national accounts, the profit and loss account is the income-expenditure. In that income-expenditure line in the national accounts, interest accruing counts as income. Write-off balance scores when you make the write-off. Those two net together to give you what your loss on your loan was. If you manage to sell them, you net the cash receipts against the outstanding balance, and that is what records in the write-off. This does not play out in the way you would expect in the national accounts

Q63 **Kit Malthouse:** If you sell a chunk, you have to bring forward the write-off, do you not?

Dr McGettigan: If you have sold it for less.

Q64 **Kit Malthouse:** They will say, "You are only going to collect 50% of this money".

Dr McGettigan: Yes. You have partially met some of that write-off by the cash you have received. That remaining outstanding balance is what scores as capital expenditure when you have closed that account. What has preceded that is the interest accruing as income. The issue is that the Government are prepared to sell the student loans for less than they say they are worth in the departmental accounts, because they are going to be using the Green Book discount rate, the social time preference discount rate, which is RPI plus 3.5%. That is higher than the discount rate used as the financial reporting discount rate for student loans, which is RPI plus 0.7%. The social time preference rate is much closer to the private sector discount rate. You would pass a value for money test even if you sold the loans at a loss.

Q65 **Kit Malthouse:** Is that because of the arbitrage between the two rates?



Dr McGettigan: It is because of the difference between the two. The difference between the two rates quantifies how prepared you are to sell at a loss and what size of loss is acceptable. The problem with the sale is it is being skewed from the start to be sold at a loss. It is not going to improve the financial position of the UK. It is going to improve some short-term presentational issues, and you are going to have cash in today instead of waiting around for payments to come in. Whether the Government should really have a preference for cash today expressed by such a large disparity between the two discount rates is a very big concern.

The other issue around the student loan is that the Government want to de-risk, but there is a whole other set of issues around that, such as if the Government really are in the best position to manage any risk with the student loans. Once a sale is agreed, it will be up to the ONS to determine whether sufficient de-risking has occurred for it to have achieved its objective of moving all that liability off the balance sheet. It is the liability of non-repayment, effectively.

Chair: That is fascinating, thank you.

Q66 **Stephen Hammond:** I want to ask a few questions so we have this clear in our minds. Is there, should there be and can there be a market in higher education? In a perfect market, we know equilibrium is achieved. It allocates resources effectively. We get into equilibrium through the supply and demand price mechanism. What we have exposed this afternoon is that there are imperfections in this market, not least subsidy, access, which affects numbers, knowledge and altruism, which affects the decision, being a public and a private decision. I wondered if you could say something about, accepting those imperfections, whether you see any other major advantages or disadvantages to marketisation of higher education.

Dr Carasso: I am going to use market language, although, as I said before, I do not think it is entirely the right language. The interesting thing in what has happened now is we have moved from a seller's market to a buyer's market in higher education. There is an expansion of places. Places are uncapped. Applicants have much more choice. That is something that we would consider to be good nationally. That is one thing that has come out of this. We see that in terms of the number of people who apply through UCAS and are unplaced being a smaller number. We see that in mechanisms for people who are trading, picking their places at university.

Q67 **Stephen Hammond:** That reflects one of the comments in the Browne Report, which said that students are best placed to make the judgment on what they want to get from participating in higher education. That is the point you are making. They would need to be making that on perfect information and a value of the future of the worth of that course. On what you have both given us as evidence, is it not fair to say that is not possible at the moment?



Dr Carasso: Absolutely, yes. The information not least on price and net cost is imperfect. Higher education is an experience good and, as such, you can never truly expect somebody who is applying to university for the first time to make a fully informed decision. You can do the best that you can. Universities do this in terms of all the activities they do to try to give people a flavour of what they are offering. It is in everybody's interest that those students make the right choices. No university wants students to drop out, to have a bad experience or to hate their studies any more than the student wants to, for many, many reasons. Yes, certainly it is not perfect.

Q68 **Stephen Hammond:** Is there more universities could do about the transparency of information, in terms of both the quality of teaching and the cost of courses and cross-subsidisation? That has an impact.

Dr Carasso: We referred to the cross-subsidisation briefly. The cost of an individual course is something that many university finance directors have spent a very long time working on through the TRAC methodology. That is increasingly considered to be another example of smoke and mirrors. Is that fair, Andrew?

Dr McGettigan: It is not really my area.

Dr Carasso: It is another example of large assumptions having to be made, for example, crudely, what proportion of this building is used for which course, what proportion of this library cost is used for this course.

Q69 **Stephen Hammond:** It may be crude, but certainly businesses do that. Other people do that in terms of allocation of fixed costs, which is essentially what you are saying. It is not impossible to achieve.

Dr Carasso: It is not impossible to achieve a figure that makes certain assumptions. University managers are doing some of this in their planning, yes.

Q70 **Stephen Hammond:** In terms of the students being able to make a better-informed decision, at the moment there is no price mechanism working, because everyone is charging the same price. Theoretically, so that students could make a greater informed choice, would it not be better to take away the price minimum and the price maximum?

Dr McGettigan: Maybe here I can come into some of the other points. In one sense, this is how you could see the Teaching Excellence Framework. The Teaching Excellence Framework is 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.

Q71 **Stephen Hammond:** That is only teaching.

Dr McGettigan: That is only teaching, but perhaps that is what undergraduates are most interested in. It is built up out of baskets of metrics and things, which means that students do not have to go away and work out what TRAC is, or how to read accounts to work out the



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cross-subsidy, or work out how student loans work. There is information you can provide, but the idea is that you can present it to people, the majority of whom are 17 at this point. There is a huge impediment here to providing the kind of information that would enable people to choose between 150 universities, 300 colleges of further education offering higher education and so on. There is a bigger problem.

Q72 Stephen Hammond: Price would not be the only signal. There is no price signal at all.

Dr McGettigan: There just cannot be while you have the loan. The bigger problem is this is not even like a utility market. Switching is almost non-existent. You get a one-off purchase and it is very hard to undo. If you were to go to a market, you would have to address flexible provision, like modular credentialisation, enabling people to test something and then change.

Q73 Stephen Hammond: We cannot do that at the moment, as you say, but many courses are now taught in a modular style these days in comparison to the Cambridge Tripos.

Dr McGettigan: You would find it very difficult to take three modules at one place and then try to switch to another institution to do the other modules.

Q74 Stephen Hammond: Currently, but theoretically that would be possible.

Dr McGettigan: Theoretically, we have been closer to this in the 1980s. We have not talked about part time, but that is the elephant in the room. One of the big mistakes of current policy is that the Open University is one of the ones that took the biggest hit to its grant income in 2012. That is the main provider of transfer of this kind and accreditation of modules. I think it lost £100 million a year from its provision. That is a point to ask: if you want a market in higher education, can it really work with the way we have it at the moment? We do not have post-qualification application for the large part. We are asking very young people to make committal decisions. We already have this problem in our system, which is that people are making committal decisions at 16 that are very hard to make.

Q75 Stephen Hammond: I recognised at the beginning the imperfections at the moment to any theory of subsidy, knowledge, access and numbers, and altruism. There is undoubtedly a public benefit to a university education. I will pursue that point for the last two questions I have, because we are dealing in theory more than in practice, and I know that you are more in practice. At the moment, if a university charges less than the maximum, it is effectively signalling that its courses are not worthwhile, notwithstanding whether it is gold, silver or bronze. Is it another reason that the price is giving the wrong signal?

Dr Carasso: The other form of pricing used a lot by applicants is the entry tariff. It is the qualifications. When I am talking to potential



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applicants they are pitching as high as they think they can with the qualifications they expect to get, as Andrew says. There is a different sort of purchasing power going on there. They see that 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.

- Q76 **Stephen Hammond:** That brings us on to a very interesting point about rational behaviour theory, does it not? You would argue that it would be in the best interests of a student to choose the most prestigious institution that will accept them, in order that the degree they get is the highest regarded and will drive higher income later in their lives. That is the basic premise.

Dr Carasso: Not every course is the best because they are a high-prestige university. There are many universities with pockets of excellence with particular courses, or they might teach in a way that is better for particular students.

- Q77 **Stephen Hammond:** But they are all charging the top whack. I know you do not want to talk about university education as a good, but it is. You come out with your glittering first class from whatever university it is, and it is highly worthwhile to you to have been at the best institution. However, as your professional life extends as you go through years, the value of your degree declines, because the value of your professional experience increases, in terms of your prospective employer, as opposed to the value of your degree. If there was a price signal available, rationally it might be better for someone to say, "I will go to the university that may not be prestigious but teaches a good course at £6,000, rather than the one at £9,000, because later on in my career people will not be asking what university I went to. They will be asking how long I spent at this particular engineering firm or whatever". There is a very interesting point here that it creates some quite big distortions in terms of people's behaviour.

Dr McGettigan: Perhaps the thing to look at is the postgraduate market, because it is largely undistorted by the loan scheme, which has only recently come in. You have a huge range of fees there. Those are prices. The problem with the undergraduate market is, once you put in the income contingent loan, you do not have a price. What you would have to do to get a price in the undergraduate market would be to make the income contingent repayment loan scheme much more onerous for young graduates. They would have to repay much more of what they had borrowed in order to get back to something that looked like a price. Alternatively, you could switch to a fixed-period repayment loan where you would feel the cost of the higher fee immediately.

- Q78 **Stephen Hammond:** But only slightly, because they would still be taking a price decision at the time of buying, and they would still have an income contingent fee against that, so they can balance that out in terms of their expectations.



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Dr McGettigan: It is not a price. It is not simply that £9,000 is a prestige thing and if you can maintain £9,000 you are better off. It is that, if you choose a £6,000 over a £9,000, you know they have got £3,000 per year per student less money coming in. That is an enormous sum.

Q79 **Stephen Hammond:** Not necessarily, because it may be that that £3,000 is cross-subsidising a course somewhere else in the university that I am getting no benefit from. You cannot make that contention.

Dr McGettigan: They may not be spending it on you, but they have the income in the first place.

Q80 **Stephen Hammond:** That is not necessarily going to benefit you. Your rational behaviour is the value to you of that degree further out.

Dr McGettigan: But then you have to test that side of it, have you not?

Q81 **Stephen Hammond:** You have, but you cannot make that assertion.

Dr McGettigan: But if they are spending it on research and boosting their prestige in that sense, you are likely to feel that benefit indirectly.

Q82 **Stephen Hammond:** Yes, I accept there will maybe be some indirect benefit.

Dr McGettigan: You are very unlikely to repay any different. Only the higher earners, and mostly male higher earners, are going to see the difference between the £6,000 and the £9,000 fee in terms of actual repayments that they are making.

Stephen Hammond: I recognise that we are talking theoretically here. We need to look at that quite carefully in terms of the way it would work economically in terms of your decision making process.

Q83 **Rushanara Ali:** Do you agree with the IFS that the high interest rates will act as a redistributive tool from higher earners to lower earners? That is what the evidence seems to be pointing to as well. Do you have any further comments to add to that?

Dr McGettigan: I do not think that is what it was meant to do. There is some careful distinction to be made between whether we think higher earners are repaying more than the equivalent of what they borrowed in the first place, so you make a little surplus on them and that cross-subsidises the scheme and brings up the average. The original design was very careful to minimise the number of people who were going to be repaying more than they borrowed and the extra surplus they would be repaying.

Q84 **Rushanara Ali:** The Government has been accidentally progressive. That is interesting.

Dr McGettigan: This is what I mean about a series of piecemeal decisions. On the original loan scheme, the discount rate was RPI plus



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2.2%, which is in the ballpark of an interest rate taper from RPI to RPI plus 3%. When you change the discount rate down to RPI plus 0.7%, all of a sudden you are making a spread and the additional interest that is being repaid is much larger. You have not changed your projection of cashflows, but you have changed how you value those cashflows.

People will not feel it in their pocket, but you are saying, "I value those repayments higher now, so I am making less of a loss". When you look at it in terms of "Am I getting more back from them than I lent to them?" it will look like that, because you have pushed up the value of all those repayments.

One thing about the design of the interest rate taper was it was tied to this idea that the cost of borrowing was RPI plus 2.2%. You can see that in the extract from the Browne Report I put in my written submission. They were suggesting an interest rate at RPI plus 2.2% in the Browne Report, and we have got one of nought to three. The discount rate change in 2015 has altered this profoundly, and not because it was a planned decision to try to introduce a redistributive element to the payments.

Q85 Rushanara Ali: Whether it happened deliberately or accidentally, we are where we are. What is your assessment of this tool, as a more redistributive mechanism for financing, given that 40% of the lower earners would be better off than the pre-2012 system? If you disagree with it, what is the alternative? What might be the alternative to this model?

Dr McGettigan: At the moment, I do not understand what it is trying to achieve anymore, because it has been divorced from the discount rate. That is my first point. Is it there because it is an incentive for higher earners to make additional voluntary repayments? The Treasury has a preference for cash today, as we know from the sale. If you have a real interest rate, is it signalling to borrowers that they should consider making additional repayments over and beyond what is demanded of them each month? That may be part of the design.

The other point is, if you lower the interest rate, the people who will benefit are the highest earners. That is clear. It is a regressive move in that technical sense.

Presentationally and optically, it is awful. You are having people making decisions: "Should I look at alternative finance options? Should I re-mortgage for the sake of my children, because I can get a lower interest rate?" In my opinion, those questions should not even be on the table. No one should be asked to make that kind of decision. The loan scheme should be clearly the best deal out there. No one should be taxing themselves to work out between the options.

Q86 Rushanara Ali: When the coalition Government introduced the higher fees, one of the arguments was that people do not have to pay until they



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earn a certain amount, at that point £21,000. Is this presentational issue one that needs to be addressed with a response that states that a smaller percentage are now going to be paying back, or is that problematic? How do you suggest that they square this issue in terms of how it comes across and how it affects behaviour at the beginning when students and families are deciding how to finance their education?

Dr Carasso: These are issues that are never going to be easy. You start getting these complex systems, with sliding scales on interest rates based on future earnings that you are uncertain about. Are they ever going to be issues that are going to be explainable, as we were talking about just now, clearly and with good information? We are talking about working out the net cost to you of your degree. How is this ever going to be explainable to the applicant? There might be political explanations and we might be able to sit in this room and discuss it.

Dr McGettigan: Also, when you are faced with it, and let us say you are a young graduate at 22 or 23, you do not know which income decile you are going to end up in. You do not know if you are going to be on the hook for that interest or not. It is a very difficult message to say to people, "Do not worry about it; you might not repay it, or you might and you might repay quite a lot".

Q87 Rushanara Ali: I do not know if Nicky had to do it too, but that is what Government Ministers were briefed to say when the increased fees were introduced and students, including many of my constituents, were relaying these messages, especially first-generation undergraduates whose families had not been. We were told, "It is not going to be an issue. It is a communication matter". You are saying it is much more complex than that. Given the complexities, given some of the presentational problems, given the pressure on students and families having to make those decisions, what is the answer? Where do we go from here? You have talked a lot about complexity, and, as you have said and some of the reports have highlighted, there is a lot of resentment of the high interest when the interest rate is so low. There are also the arguments about intergenerational financial burdens. Where do we go from here?

Dr McGettigan: I apologise for chucking in a few extra things here. The interest rate on pre-2012 loans is 1.25% nominal, because it is the lower of bank base rates plus one percentage point or RPI. That is written in the primary legislation for those loans, and it was changed by the 2011 Education Act for post-2012 loans. Are there enormous problems with the pre-2012 loan because of the interest rate? In effect, it is a rhetorical question.

The main problem is that, once you have such a large initial graduating debt, and once you are applying a real interest rate to people when they are studying, it becomes a completely different focus. If you have lower starting debt, the interest rate is not going to apply in the same way.



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I did a rough and ready calculation this morning, and I cannot quite find it in my notes. On the new scheme, if you have £45,000 of graduating debt and you earn £45,000 a year, you are going to repay about £1,800, because that is 9% of the £20,000 over £25,000. The interest accruing against your balance is going to be something like £2,500 or £2,700. Someone earning a very good salary for a graduate is going to have mandatory monthly repayments lower than the interest accruing against them. That is a very bizarre situation to present to people. That is not just a function of the interest rate; that is a function of the graduating debt. If you want to cut the knot here, maybe it is that fees are too high, because then all these other factors come into play.

We are tending to talk about the loan scheme for full-time undergraduates, where you can, in all good conscience, say, "You have £45,000 of debt. It is very unlikely you are going to repay the principal, let alone the interest. Just think of it like a graduate contribution, a 9% tax over £25,000". If you have a postgraduate loan, that is RPI plus three percentage points, no taper, and you have borrowed £10,000. That interest will kick in more significantly, and you will end up repaying a higher proportion of interest than you would on the full-time undergraduate loan.

If you are a part-time undergraduate, similarly you will have a lower graduating balance, but you have a very high interest. The extra amounts you repay are more likely to be against interest than just against principal. In these cases, where because of these slight differences in design—one is £10,000, one is £20,000, one is £40,000—they have similar or worse interest rates, you see a very different effect. You end up repaying much more interest than principal.

Q88 Rushanara Ali: That is if you are part time or a postgrad.

Dr McGettigan: Yes, purely because you are starting from a lower graduating debt with a high interest. It is very complicated.

Q89 Rushanara Ali: Dr Carasso, did you want to add any further points, to focus on what we do? What would be your recommendation on tidying this up? This has been a really informative session, but it would be helpful to think about where we go next.

Dr Carasso: I would like to reiterate the point that, if it is too complex to understand, it is a problem. We need to be clear, as the people making the policies, what we are doing, how we are doing it and why we are doing it.

The point that Andrew just mentioned in passing is that fees may be too high. Why do we not have an employer contribution coming in here? Why are we taking so much from the students? We talk about a system in which those who benefit should be making a contribution. Employers benefit from a skilled and educated workforce, and that has slipped away from national debate over a number of years in the changes that have



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been made to funding. We are now looking at the apprenticeship levy, and I would like to see that being asked as a question.

Rushanara Ali: You mentioned that in your article as well.

Dr McGettigan: I have one very quick point: the interest rate on pre-2012 loans is recognised to be an impediment to their sale to the private sector, because it is below RPI. Another thing you have to factor in here is whether the overall real interest rate design is also because it is much closer to a private sector preference for potential purchase of post-2012 loans if they are ever offered to market. This is the problem.

Q90 **Rushanara Ali:** What is the recommended rate?

Dr McGettigan: What are your policy objectives? What are you trying to achieve? If you are desperate for a sale, a lower interest rate is going to present problems for that.

Q91 **Rushanara Ali:** Being a Labour politician, I am much more interested in what the effect is on students, so some of the earlier points you made about what incentives or disincentives students have when they are making those decisions.

Dr McGettigan: The interest rate has to be lowered, for all the reasons that are set out before us, as a presentation issue. It could even be lowered to the financial reporting discounting rate or thereabouts. That was what was behind the original design, as far as I understand. At the same time, once you have such a large graduating debt, the interest rate has more effect, so abolition of fees or lowering fees significantly would also have a beneficial effect in that regard.

Chair: I am going to draw it to a conclusion there, because you have given us plenty to think about. Thank you both very much indeed for your time. Dr McGettigan, I know that you have to go through it all again with the House of Lords in the not too distant future.

Dr McGettigan: On Tuesday, yes.

Chair: I hope we have given you a warm-up and it has been of value to you. We are very grateful. It has been an informative session with plenty to think about. I cannot promise we will not write to you with the odd further question if we hear things in further evidence sessions, but, for now, thank you very much indeed for your time.