HOUSE OF LORDS

Select Committee on Economic Affairs

Corrected oral evidence: The Economics of Higher, Further and Technical Education

Tuesday 7 November 2017

3.30 pm

Watch the meeting

Members present: Lord Forsyth of Drumlean (The Chairman); Baroness Bowles of Berkhamsted; Lord Burns; Lord Darling of Roulanish; Baroness Harding of Winscombe; Baroness Kingsmill; Lord Layard; Lord Sharkey; Lord Tugendhat; Lord Turnbull.

Evidence Session No. 5 Heard in Public Questions 41 - 53

Witnesses

I: Professor Madeleine Atkins, Chief Executive, Higher Education Funding Council for England; Dr Philippa Lloyd, Director General of Higher and Further Education, Department for Education; Nicola Dandridge, Chief Executive Officer, Office for Students.

II: James Bowler, Director General, Public Spending, HM Treasury; Charles Roxburgh, Second Permanent Secretary, HM Treasury.

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Examination of witnesses

Professor Madeleine Atkins, Dr Philippa Lloyd and Nicola Dandridge.

Q41 **The Chairman:** Professor Atkins, Ms Dandridge and Dr Lloyd, welcome to the Economic Affairs Committee. I think this is your second appearance in just over a year, Dr Lloyd.

I will begin by asking the first question. Jo Johnson said that he is keen to see the cross-subsidy between lower-cost and higher-cost courses reduced. How could that be achieved? What would be the effect on the universities? Shall we start with Dr Lloyd?

Dr Philippa Lloyd: Okay; Madeleine was about to plunge in.

The Minister is after greater transparency around funding and what funding is used for. He is encouraging that. Obviously, it is quite tricky. With differential fees, you have to be careful that you do not end up putting off people who might want to study courses that are more expensive. You have to think about aggregation and, possibly, the level of taxpayer subsidy versus graduate contribution. Transparency can be helpful, but you need to think quite carefully about how you manage it. That would be my initial answer.

The Chairman: When you gave evidence to the Committee in July 2016, we asked you what analysis the Government had made of the impact of differential fees and whether they could incentivise students to apply for courses where there are skills gaps. You said that "this is an issue that has come up. I would say it is work in progress at the moment". How much progress have you made?

Professor Madeleine Atkins: The first point is that no vast profits are being made anywhere on UK and EU undergraduate fees. There is a sense sometimes in the media that classroom-based subjects are overpriced at £9,250, and that a considerable surplus must be being made there, which is then directed to higher-cost courses. Our analysis suggests that that is not the case. Indeed, any surplus on classroom-based courses is eroding fast, due to inflation and other things. The main cross-subsidy at the moment is from international student fees, not from home and EU fees. That needs to be understood.

The Government intervene, and have intervened historically, to preserve subject areas that are vulnerable because of low student demand but that are important to the country's security or economic future. For example, in the past, additional grant has been given to physics in order to preserve it, because the Government believed—rightly—that that STEM subject would be important in the future, even if there was not much demand from students at the time. That has also applied to minority languages.

From time to time, the Government have put additional funding into the higher education system to incentivise courses in new areas. For example, we have had calls for new courses in Mandarin and in economic and social studies of greater China. That was 20 years or so ago, at a time when this country believed it was important that we had more graduates with knowledge and skills in that area. We have just put out a call for another 1,000 undergraduate medical places. The Government can incentivise both the retention of courses that are important to the country and new areas of provision. They have done so successfully over many years.

The Chairman: When Jo Johnson said in an interview in the *Times* last month, "It's important that students think they get value for money … I'm keen to see cross subsidy between lower-cost courses and higher-cost courses reduced", what did he mean?

Professor Madeleine Atkins: I am afraid that I cannot speculate on what lay behind that particular comment from the Minister.

The Chairman: Was he wrong?

Professor Madeleine Atkins: We would say that, at the moment, the subsidy is from international students into areas of higher cost. On our analysis, the high-cost subjects at undergraduate level are all running at a deficit.

Q42 **Lord Darling of Roulanish:** I want to ask you about the concept of competition. In a recent consultation period, the department said that the new system was "well suited to market mechanisms driving continuous improvement". I am bound to say that, so far, a lot of the evidence that we have heard disputes that. I would be interested to know what evidence you have that would demonstrate that what we have is well suited to a market solution—leaving aside whether you want that in the first place.

Dr Philippa Lloyd: To begin with, we had the Competition and Markets Authority look at the higher education sector back in 2015. It thought that the sector was indeed amenable to market regulation. Perhaps you have not seen much evidence of it so far, because we have only just put in place the legislation to set up an appropriate market regulator. Institutions compete for students at local, regional, national and international level.

Lord Darling of Roulanish: Can I stop you there? What are they competing on? It seems to me that it cannot be price.

Dr Philippa Lloyd: No, they are not competing on price.

Lord Darling of Roulanish: What are they competing on?

Dr Philippa Lloyd: They are competing on attracting students.

Lord Darling of Roulanish: Yes, but on what?

Dr Philippa Lloyd: Basically, on courses. They are attracting people to institutions to pursue courses.

Lord Darling of Roulanish: On the basis of what they say in the spiel they put out.

Dr Philippa Lloyd: Yes. The purpose of the legislation, and the thinking behind the White Paper, was to put competition and informed choice at the heart of the system. Things such as the teaching excellence framework, the student outcomes framework and the longitudinal educational outcomes work are all about giving students and parents more data to inform their choices.

Lord Darling of Roulanish: The prospectuses for universities are all generally well written, and they all tell you what a wonderful place it is. It has been put to us that very often students do not know until they get there that, for example, tutorials have an awful lot of people in them at one institution, but only half a dozen somewhere else, say, Oxford or Cambridge. That is an issue not just from the students' point of view, but from the Government's point of view, because it is in the country's interest that we have properly educated students, and graduates at the other end. How can you ensure that there is informed choice, as opposed to something that looks good in the application but does not turn out that way when people get there?

Dr Philippa Lloyd: I understand that. That is why things such as the teaching excellence framework, which gives information about the standard of teaching and so on, are very important. They are independent assessments of institutions. I understand entirely what you mean about prospectuses or brochures. As I said, we have LEO. It is very raw at the moment, but it will be developed. It is about improving the information available; absolutely. There is also something about making transfers between institutions easier—to promote easier transfer if people are not satisfied or their intellectual and educational needs have changed. I will ask Nicola to comment on that.

Nicola Dandridge: One of the themes that run through the regulatory framework consultation is the importance of effective information, advice and guidance, not just for young people but for mature applicants. Effective careers advice has to be part of that, so that when students apply to universities they are aware of what the particular courses offer—what qualifications are on offer—and how that will lead to the outcomes they want. One of the primary responsibilities of the new Office for Students will be to look at how we can improve information, advice and guidance for applicants, to address exactly the deficit—if there is a deficit—that you identified.

To go back to your question about the market driving up quality, inherent in the regulatory framework consultation is an acknowledgement that it is not only the market that will drive up quality. We have a proposal for a quality threshold with which providers will have to comply if they are to get on to the register and access public funding.

Lord Darling of Roulanish: What is that quality threshold?

Nicola Dandridge: It is a whole range of metrics that they will need to satisfy in order to get on to the register. The Office for Students will need to evaluate whether or not a provider satisfies that threshold. Beyond that, all manner of drivers and levers are available to drive up quality. An obvious example is access and participation plans, which will require continuous improvement for providers in relation to social mobility. There is a fundamental acknowledgement of the role of the markets. I would categorise that in terms of prioritising student choice—making sure that students can choose the right course for them. Beyond that, there are other drivers in play.

Lord Darling of Roulanish: It is this question of informed choice. I take the point that Dr Lloyd is making, but there is a world of difference between the resources available to universities in the Russell group, for example, and those available to institutions that may be struggling and do not have the same historical resources to draw on. Both from the students' point of view, which is important, and from the point of view of society at large, I wonder whether there should be some quality control there, so that we do not just leave it to good luck or good fortune that it all works out.

Nicola Dandridge: You are asking absolutely the right question. There are quality controls on the information that is put out, in the sense that universities cannot say something misleading. That is the case already. I see it as one of the primary responsibilities of the Office for Students to enhance the information, particularly for students from disadvantaged backgrounds, who may not have access to the same quality of advice. That will land very squarely on our desks and will be an important part of our role.

Lord Sharkey: I support that. How well informed are applicants at the moment? How do we know how well informed they are?

Nicola Dandridge: That is a very good question. A range of surveys exist. The Student Room, for example, has done surveys of students to ask them whether they feel that they made the right choice. The record is patchy, to be perfectly honest. Many students are making the right choice, which manifests itself in retention and outcomes, but that is not the case for all students. Clearly, some of them are not getting appropriate or sufficient advice, but I think that is remediable. It can be addressed.

Lord Sharkey: We would hope so. What plans are there to address it? The issue of whether students are well informed when making what is, for most people, a once-in-a-lifetime choice is critically important. What plans are there to have some system that does not depend on anecdote or The Student Room to tell us whether students are, in fact, well informed?

Nicola Dandridge: It would be wrong to say that there is no advice now. Clearly, there is. Schools are giving advice, and there are many professional advisers. The point is that it can and should be a lot better.

You asked about plans. The Office for Students does not yet exist. We will not exist until 1 January, so we do not yet have any plans. It is one of the issues we are consulting on, and I see it as a real priority for us to try to link up with schools, careers advisers and excellent organisations such as the Careers & Enterprise Company to make sure that there is more consistency and quality in the advice going to students, particularly those from disadvantaged backgrounds, who may not be getting the same quality advice as others.

Dr Philippa Lloyd: In another area of my responsibilities, we are working on a careers strategy to try to improve the information, advice and guidance that is given to students in school. Of course, we also have reforms in other areas—technical education and so on—so that people have a greater variety of really good opportunities to fulfil their potential.

Lord Turnbull: Even if you are successful, and students are able to make a better-informed choice than they make at present, universities have extensive freedom as to what they offer, and the supply and demand of those two things come into balance, I question whether that will necessarily produce the optimum social outcome. We may find that we need certain skills that are not being produced adequately. What instruments do you have to identify where you think there is a mismatch? Where would you apply them?

Professor Madeleine Atkins: I can give an example of that right now. The Government are about to introduce an Institute of Coding, which is particularly designed to bring computer science and related subjects more into line with the graduate skills that the business community requires in that area. It will be a consortium-based hub, effectively—with a consortium beneath it. That is one example of an instrument that the Government have at their disposal to incentivise the universities involved to get alongside industry and really understand the way demands for advanced skills and knowledge are likely to develop in the next 10, 15 or 20 years.

The most recent initiatives that the Government have put through have all had employers and universities working closely together. They include degree apprenticeships and Institutes of Technology, which are now coming through. There are informal and formal ways of achieving these outcomes, but requiring effective partnership between the providers of higher education and the employers who are going to pick up those graduates is one part of the answer.

Lord Turnbull: You used two words there: "employers" and "businesses". Employers is the better word, because it could equally apply to government and all the services that it provides.

Professor Madeleine Atkins: Indeed. The health service would be a key example.

Lord Layard: Could you say more about practical things that need to be done to make transfer easier? To say that we should make it easier does not help, unless we know what we would do to make it easier.

Nicola Dandridge: It is a core part of the regulatory framework consultation. We are being tasked specifically with making transfer easier. One of the proposals in the consultation is that all higher education providers must set out what they propose to do to make transfer easier for students. There is a real imperative running through the consultation to try to achieve more, and more effective, transfers. We will be looking into that. Indeed, one of the consultation questions is, "How can we make transfers more effective?" It is firmly on the agenda.

Lord Layard: Is there not a national problem, to do with entitlement to loans, for example, if students move? Can they find themselves unable to get through to the end of the course because they have exhausted their loan? There must be things that have to be done nationally, rather than just asking institutions to do it themselves.

Dr Philippa Lloyd: They do not lose their loan. If they are still studying for an undergraduate degree, they take their loan entitlement with them.

Professor Madeleine Atkins: The question is the extent of the change in the course for the particular student. Transferring from one institution to another and, effectively, taking the same course is not so difficult. The problem comes if the course the student chooses to transfer to is very different from the course they started initially. Where we see that happen, it is partly due, I am afraid, to specialisation in the 16-to-18 years curriculum. Students can arrive expecting certain things and then find that it is not what they want to do, and they want to do something different. It becomes a little more complex at that point.

Lord Sharkey: Does that mean that you support David Willetts's recent statement that he is in favour of four-year courses?

Professor Madeleine Atkins: I saw Lord Willetts's comments to that effect. We will see. It is certainly true that some institutions in Australia, for example, have moved to four years, despite having a loans system not that dissimilar from ours. I believe that one or two universities in this country are already looking at a four-year approach, as well as a two-year, highly concentrated, approach. What may lie behind that is the Government's desire for greater diversity in the choice and type of provision that should exist for students, and, to that extent, for employers. To be fair, most of our undergraduate programmes through to chartered status in engineering, chemistry and physics are four-year courses already, with the final year having a considerable element of research and really advanced skills and knowledge. It is not true that we do not have four-year courses at the moment.

Q43 **Lord Layard:** I want to ask about grade inflation. As we know, there has been a lot of it. What is your approach to that? Do you think that tuition fees have made it worse? Do you think that the teaching excellence framework is in danger of making it worse, if grades are part of the index? What will the Office for Students do to try to stop grade inflation?

I would really like to know whether you think it is a problem and how you intend to approach it.

Dr Philippa Lloyd: The Minister is certainly concerned about grade inflation. He spoke about it vigorously over the summer when announcing revisions to the teaching excellence framework; a grade inflation metric is now being put in. He has challenged the sector to come up with sector-specific standards to help to ensure that the qualifications students achieve have lasting value. He is asking the OFS to analyse the evidence and data on that on an annual basis.

Professor Madeleine Atkins: This year, we will have supplementary information about degree results. What the Minister is going after is unwarranted grade inflation, as opposed to an increase in Firsts and 2.1s that is entirely justified, either by students arriving with better qualifications from their 16 to 18 year-old time or from the learning gain they have achieved. It is quite a complex area. Our analysis so far suggests that as A-level grades improved, so did the numbers of Firsts and 2.1s. We now need to watch whether, since A-level grades have plateaued—no doubt there are some reasons for that—the number of Firsts and 2.1s will continue to rise or whether they, too, will plateau. We do not know yet, because we have not quite got to those cohorts' graduations. The trick, at least for the assessors, will be to discriminate between bona fide increases in the numbers of Firsts and 2.1s and those that are not bona fide. That will be quite complex.

Nicola Dandridge: The Office for Students has been tasked specifically with producing an annual report on grade inflation, in which we analyse the statistics and trends. It is something that we will take forward as well.

The Chairman: What would the Minister do about it? I am looking at the figures. In 2015-16, 24% of students gained a first-class degree, up from 17% in 2011-12 and 7% in 1994-95. Three-quarters of students now gain a First or Upper Second, compared with 66% in 2011 and fewer than half in the mid-1990s. If the universities cannot compete on price to attract students, would a good way of attracting students not be the prospect of getting a first-class degree?

Nicola Dandridge: That is possibly why this has been passed on to us.

The Chairman: But what will you do about it?

Nicola Dandridge: It plays itself back, potentially, through the conditions that the OFS will monitor. We have to monitor compliance with those conditions. Clearly, it has not been proposed that there be sanctions. None the less, it is—

The Chairman: Am I being stupid? If you say, "These universities have far more people getting first-class degrees", will that not result in more people wanting to go to those universities?

Nicola Dandridge: There are those pressures. Indeed, it is reflected in some of the league tables as well. The more Firsts, the better the institution performs. There are unhelpful pressures of that kind. That is precisely why it is an area that the Minister considers needs regulation.

Dr Philippa Lloyd: It is why the metric has been included in the teaching excellence framework. That is meant to act as a counterbalance to the pressures arising from league tables and so on, which push things in the wrong direction.

Q44 **Baroness Bowles of Berkhamsted:** I would like to move on to some points about further and technical education. It was announced last week that there would be a review of higher-level technical education, in particular, funding and how it will link to higher education funding. Could you say a little more about that? How will it relate to qualifications and people being able to upskill and retrain to get the skills they need for the workforce? Has it got that far in the planning?

Dr Philippa Lloyd: This is taking forward work in response to the Sainsbury panel report. At the moment, we are developing T-levels, which are level 3—the same as A-levels—looking at 15 occupational routes. Prospective students need to see a pathway through. It needs to go all the way up from level 3 to levels 4, 5 and 6, and beyond. We have announced a review into level 4 and 5 provision—what you referred to as higher-level technical education—because we want to understand better the needs of learners and employers around that, and to be able to build pathways through those qualifications. That is why we announced the review. It is not specifically about funding; it is more about how we better meet the skills needs of the economy. People often comment that we are short in intermediate technical skills, which we would get through level 4 and 5 provision.

Baroness Bowles of Berkhamsted: To what extent does technical education happen in universities?

Dr Philippa Lloyd: About 42% of courses offered by universities cover technical education.

Baroness Bowles of Berkhamsted: Is there a desire to try to increase that?

Dr Philippa Lloyd: The desire is more to increase the amount of sub-degree provision. FE colleges are well placed to offer that provision. It is about building a much more credible college-based offer that sits alongside university provision, to give people a wider range of options than they currently have and that may be better suited to their aptitude, ability and circumstances.

Baroness Bowles of Berkhamsted: Where have we got to with the demand for advanced learner loans? Some suggest that they are being taken up only by those in the types of professions where people do not ever expect to earn enough to have to repay them. They do not take them if they fear that they will to repay them.

Dr Philippa Lloyd: We are still looking at all that. We want technical education in this country to be much more of a success story than it has been before, so we will have to look at that as well.

Baroness Bowles of Berkhamsted: Hopefully, the people who have the technical education will learn more and will not be afraid of taking the loans.

Dr Philippa Lloyd: In the early data that we have on apprenticeship starts, we see a lot of interest in level 4 and 5 apprenticeships. The number of starts is still low at the moment, but the early data indicate that there is demand for those levels. It is about trying to ensure that the system meets the demand.

Q45 **Lord Burns:** Can I move on to alternative ways of studying? Are you concerned about the decline in part-time study?

Professor Madeleine Atkins: Yes, we are. We have seen a 61% drop in part-time student numbers over quite a short period, from about 2007-08 onwards. The drop began just after the financial crisis of 2008. One could fairly say that it has accelerated with the introduction of higher fees.

Is it a worry? Yes, it is. It is quite a complex area. The numbers of young students—18 and 19 year-olds—who are studying part-time, at 50% intensity or a bit more, have held up. They are pretty much the same as they have been historically. The numbers that have declined are those over 25 years old—the more mature students. There are a number of factors behind that. For example, employers have perhaps not been as ready to invest in skills training in this period. Wages have not increased much over the last decade, so there has not been as much surplus income in families to self-fund. The result of that is worrying both for the country's skill demands and, in particular, for the reskilling and upskilling that we see as being needed across many sectors, particularly with digitalisation/AI coming in.

Lord Burns: How would you balance the explanation of that between the changes to the funding regime and the extent to which the universities want to take younger students?

Professor Madeleine Atkins: Universities respond to student demand. If the demand is there, they will put on provision. It is a market. To that extent, the Government have been highly successful. The student number controls have come off. This is affected by a complex set of factors. There is not one thing that predominates particularly.

Lord Burns: You do not think that the funding regime changes have been a dominant factor.

Professor Madeleine Atkins: Possibly. That would assume that mature students are more debt averse than younger students, but we do not yet have the hard data, and the hard analysis behind it, to be 100% sure that that is the dominant factor.

Lord Sharkey: Professor Atkins, is it not the case that, since the fees have been frozen at £9,250, there is a looming crisis for universities, anyway, in how they finance themselves? That will exacerbate the problem Lord Burns is talking about, of getting funding for part-time students. Your own annual report showed that the net debt for universities—the excess of borrowing over liquidity—currently stands at £577 million, and you expect it to rise to £5 billion by 2019-20.

Professor Madeleine Atkins: Yes, we do.

Lord Sharkey: Surely that is not sustainable, as you say yourself. It is likely to put enormous pressure on universities accepting part-time students.

Professor Madeleine Atkins: We also say that the surpluses that are now forecast, which are very thin, assume that universities themselves will make no further efficiencies or cuts in that period. Universities are very good at doing their scenario planning and contingency planning. We are well aware that that is going on across the sector. The diminution because of the freeze on £9,250 is something like £113 million less than expected in 2018-19 and something like £334 million less in 2019-20. In other words, parts of the sector had already factored in the possibility that the fees would not rise. A fair number of our institutions have done that.

We say that the situation is reasonably sustainable in the short term but not sustainable as a long-term trend. The gearing in the sector is somewhere around 34%, 35% or 36%. Again, that is reasonable in the short to medium term, but really close attention to operating cash flow is now very important for every institution.

Q46 **Lord Layard:** I want to ask a question about the consistency—or lack of it—between the way in which universities are funded and the way in which FE is funded. Universities have a single integrated funding system. FE is funded by hundreds of different little bits and pieces of money. People might say that the fragmentation of FE is justified because it is doing vocational stuff, so it gets a little pocket for this, a little pocket for that and a little pocket for something else. Then we are told that half of what universities are doing is vocational, but that does not lead to their getting a little bit for this, a little bit for that and a little bit for something else. Is it not time radically to rethink the funding of FE, to get a more unified system of longer-term funding, instead of short-term parcels?

Dr Philippa Lloyd: I agree that further education definitely needs attention, which is one of the reasons why we are doing the reforms. You are absolutely right. When we are doing those reforms, we cannot just build T-levels; we have to look at the capacity and capability of the sector, the information, advice and guidance that is provided to students, parents and so on, and how to get people to appreciate the value of a technical education. We have embarked on a pretty big programme of work in order to try to deliver successfully the 29th reform in technical education. You are right; it is a huge task.

The Chairman: Lord Burns, we cut you off in mid-sentence.

Lord Burns: What should be the response to the problem of the decline in part-time education? Are we just going to leave it? Are we just going to say, "This is the way the world is", or is it an area that needs serious investigation? Do you have any proposals for that?

Professor Madeleine Atkins: You are absolutely right; it is an area that needs further investigation. Historically, we have looked at it from the supply side of programmes. We need further and better information about the demand side of the nexus. Various groups have put forward ideas as to how the problem might be countered. Indeed, the Government themselves are looking at introducing maintenance loans for part-timers, from 2018-19, which may help the situation.

There has been the suggestion that, once we have the apprenticeship system really bedded in, settled down, and so on, there may be a bit more flexibility around the use of the apprenticeship levy, which would enable small employers, in particular, to fund their employees for shorter training, rather than a whole apprenticeship programme. That is for the Government to consider some way down the track. At the moment, the important thing is to get the apprenticeship system well and truly bedded in.

Lord Turnbull: We have to remind ourselves that we are covering all post-school education. We happen to be starting with higher education, and it is really easy to get obsessed by that. I want to look at the contrast between the non-university channel and the university channel. Paragraph 11 of the written evidence adds up the figures. There are 3.5 million students in further education, and the total cost is £9.8 billion, which is £2,700 per student. In higher education, there are 1.5 million, but the total amount of money going into the sector is £17.8 billion, which is £11,000 per student. The cost to the Government is supposed to be £7.6 billion. I am not quite sure how much of the £15 billion you are assuming will not be repaid. With such a gap between the almost lavish funding of higher education, at £11,000 per student, and the funding of £2,700 per student in FE, it is not surprising that people think the other channel is not really getting a fair share.

Dr Philippa Lloyd: I refer to my earlier answer. I would also say that further education covers a huge range—everything from basic skills through to the technical education I referred to, as well as adult community learning and so on.

Lord Turnbull: In a SWOT analysis of the UK, weakness in the university sector would not come high up, and weakness of the non-university channel would come very high up, yet there is this massive disparity in funding. You may be able to give us the figures. Those were the figures for 2017-18. I suspect that it has been getting worse, in the sense that the universities' funding has been going up and funding for FE has been going down.

Dr Philippa Lloyd: The apprenticeship levy helps to counterbalance some of that, but we are very aware that, as the Sainsbury panel report pointed out, our technical education is not where it needs to be. That is what we are focused on.

Baroness Kingsmill: It seems to me that there are lots of different priorities or objectives that do not necessarily mesh together particularly well. I would like to hear your comments on that. It seems that we want social mobility via our tertiary education; we want to fund universities sufficiently well to enable them to improve their standards and to teach well; and we want to meet the needs of the economy. Another objective that we often forget is giving students value for money. How do those things mesh together? How do you see the priorities there? Where do you see the real problems and issues? Could you draw our attention to the things we should focus our minds on in respect of those four issues?

Dr Philippa Lloyd: Across the whole of higher and further education?

Baroness Kingsmill: You can decide. The answer is probably yes, but it is probably easier to focus on universities at the moment.

Dr Philippa Lloyd: An awful lot of attention—and I am saying this from the outside—is paid to skills policy, in its wider sense, in higher and further education. We do an awful lot of supply-side reform, but we need to pay much more attention to the demand side, so we are engaging employers much more in our reforms around apprenticeships and technical education. In order to be successful, we need to ensure that the qualifications and routes we are building will be highly valued by employers. That will benefit both the economy and social mobility. It is hard. As I said, it has been tried many times before; it is difficult stuff. Some of it is about a culture change in society. Society tends to prefer the more academic route to the technical route. Building a strong and credible technical offer is one of our top priorities at the moment.

Professor Madeleine Atkins: Many universities are place-makers in their location. One of the ways in which the Government have supported that is through the funding for knowledge exchange, which is an element of the funding that we provide currently but Research England will provide in the future.

Although you might describe the competing demands as tensions—running a university is certainly a complex business because of them—they can sometimes come together, behind one another. It is reasonably straightforward to bring together social mobility, place-making and the needs of the economy in a particular area in some quite compelling course offers, and engage local employers in their design, and so on. Of all the problems we have been looking at and trying to resolve, perhaps the most pressing is that of unequal outcomes by ethnicity and social class across the university sector. I cannot comment on the FE sector, but it may well be the same. The really critical, pressing issue on the social mobility side is progression outcomes for certain groups of students, which mean that the return on their investment—if you want to put it in those terms—is not as great as it should be.

The Chairman: I will take questions from Lord Darling and Lord Burns.

Baroness Kingsmill: Can I hear from Ms Dandridge? She was going to say something about the point that I raised.

The Chairman: Can you make it very short? We have quite a lot to cover.

Nicola Dandridge: I will make it very short. It is a really good question. Those tensions are inherent in, for example, the regulatory framework consultation, which constitutes the bulk of what the Office for Students will do. I would not want the Committee to think that the tensions are necessarily a bad thing; they reflect the fact that higher education does so much, in so many different ways, for society. If that is the case, it is inevitable that there will be competing demands. That is probably a good thing, not a bad thing.

Baroness Kingsmill: I will come back to the value for money point, which none of you has answered.

Lord Darling of Roulanish: My question follows from a question that Lord Turnbull asked. He mentioned the disparity between the funding for university students and for FE students. We have been told time and again that a lot of universities are offering "technical education" and that the divide between what is university and what is FE is not so clear. I wonder whether it should not be clearer, given the disparity in funding and, therefore, the disparity in cost as well. I know that the argument about what is FE and what is HE has been going on ever since 1964, but what do you think about all that? Should we be looking at that divide again? I do not know whether that is policy or practice.

Dr Philippa Lloyd: I agree absolutely that it is complicated.

Lord Darling of Roulanish: Is that the answer?

Dr Philippa Lloyd: No. I was going to say that it is something we think about. One of the advantages of having all of HE and FE together under the Department for Education, which was not the case before—it was split—is that it gives us an opportunity to look across all of that to see whether we can make better sense of it. We also need to help students to navigate that landscape, so that they can make good decisions for themselves. My top answer is that it is complicated. My second answer is that we are aware of it and are looking at it, but it is not straightforward.

Lord Darling of Roulanish: Are you actively on the case, or is this in the basket of lots of things that are being looked at?

Dr Philippa Lloyd: In order to make things such as T-levels and technical education successful, we must be actively on the case.

Lord Darling of Roulanish: By the time you are the Permanent Secretary, we will have an answer.

Professor Madeleine Atkins: At the moment, we fund directly 190 further education colleges that offer higher education provision. It is funded at exactly the same rates as higher education in universities. There is no difference. What we see is that further education colleges provide courses that are often tailored to the local context and that cater particularly for those who are not mobile and who cannot go across the country to study. Given the quality assurance work that we have done around further education colleges—some of which got gold in the TEF—we would be concerned if higher education were removed from those colleges, because of the reduction in opportunity that would then be offered, particularly to mature students in those areas.

The Chairman: Do you want to come back, Lord Burns?

Lord Burns: I have a quick question, although it may not be answerable. I am most struck by the idea that this is the 29th major piece of reform. Have you done any work on what went wrong with the other 28?

Dr Philippa Lloyd: Yes, we have. The Institute for Government said that recently. We have indeed looked at quite a few lessons learned, because it would be really good to crack it.

Lord Burns: Can you summarise them quickly?

Dr Philippa Lloyd: Sometimes, people have tried to tackle reforms without sufficiently involving employers. Sometimes they have done it with employers involved, but without really establishing that employers would take people with those qualifications. There are also things about understanding how and why people make certain choices. One of the things that we are trying to do this time, which is not meant to sound novel, is to talk to students, parents and teachers about how they think about the decisions that they are going to take, so that we can think about what worries them and, therefore, ensure that what we are doing helps to deal with those concerns. There are all sorts of issues, but we need to get the value and the pathways really clear. That has not been done so well previously, so we are trying to do it better this time.

Lord Sharkey: In evidence, Cambridge University told us that around two-thirds of specialist university centres for continuing higher education have been closed. It does not say over what period, but two-thirds is clearly a very large number. Is there a structural problem that we need to address? Is sufficient provision available to restart part-time education?

Professor Madeleine Atkins: That is an interesting figure. We are aware that quite recently a number of universities have closed their outreach and extension work, although much of that was targeted at courses that were not necessarily the technical courses we discussed in earlier questions. You also need to understand the potential and, in some cases, the implementation of learning through media and online programmes, which may be more accessible for employees and adult learners. The ways in which part-time learning can be delivered are changing, and that is one of the issues that we need to understand and get behind.

Q47 **Lord Tugendhat:** I apologise for arriving late. Can I tell you why I was late? I was late because I went to the unveiling of the new statue of George Orwell at the BBC. There is a very good inscription beside it, which reads, "If liberty means anything at all, it means the right to tell people what they do not want to hear". Do you agree that that is particularly apposite for the university sector at the moment?

The Chairman: I think that is one for you, Ms Dandridge.

Lord Tugendhat: Are you able to answer that?

Nicola Dandridge: I can answer it, but in a very provisional way. I say that because, as I have said before, the Office for Students does not yet exist. This is absolutely on our agenda as an issue we need to get to grips with. We must decide how to respond in an intelligent, thoughtful and balanced way. I am slightly reluctant about anticipating those discussions, because it is not a straightforward area. That said, the Minister could not have been clearer about the fact that it is one of the issues he wants us to deal with. We will consider what free speech and academic freedom mean, and we will take that very seriously. I am reluctant to go further at this stage, but I will be delighted to follow up in six months' time with a more substantive response.

Q48 **Lord Tugendhat:** I am sorry for springing that on you, but it seemed rather apposite. The question that I am down to ask you is this. What sort of new institutions do you anticipate will enter the higher education market as a result of the new regulatory framework?

Professor Madeleine Atkins: Over the last few years, since the alternative provider sector was brought into being, we have seen a steady but small stream of truly innovative new provision and providers—for instance, the Dyson Institute of Engineering and Technology, and the New Model in Technology & Engineering institute. From the discussions we have been having across the sector and beyond, we anticipate that a small stream of high-quality, innovative provision will continue to come forward, but from the work we have been doing and our current discussions, we do not expect a deluge. The most likely trend under the new regulatory framework is that those who currently hold course designation, as it is called, will come forward for degree-awarding powers and, ultimately, university title. Those are institutions already within the regulated sector; they have just not reached the two upper levels yet. We think that that is where the push will come initially.

Lord Tugendhat: Do you think they are likely to be more apt to offer accelerated degrees?

Professor Madeleine Atkins: Yes. The change to the funding makes it much more attractive for a provider to offer that now.

Dr Philippa Lloyd: New Model in Technology & Engineering, the institute that will come into being in Herefordshire, has already said that it wants to offer two-year degrees. It wants no lectures; it wants to do project-based learning and close work with employers, with six to 12-month work placements. It is also going for a 50:50 gender ratio.

Lord Tugendhat: One would assume, prima facie, that an accelerated degree would cost the student less than a longer degree, although I imagine that there are higher living costs, because presumably the student has to spend more months at the institution in two years than they would spend there if they were doing a three-year degree. Is there a problem for people from poorer backgrounds with doing an accelerated degree?

Professor Madeleine Atkins: It is the reverse of that, I would suggest. Most students have to take out a contract on their accommodation that runs for a considerable period of the 52 weeks in the year. In our calculation at least, those on two-year accelerated degrees should be under less financial pressure.

Lord Tugendhat: I see. My children had to do that when they went to university, whereas when I was at university we paid only for when we were there.

The Chairman: Baroness Harding has been trying to get in.

Baroness Harding of Winscombe: I apologise for the fact that I had to duck out earlier. I have a follow-up question on what we can do to reverse the decline in part-time higher and further education, particularly for older students. Last week, we heard about the Australian system, where—as I understand it—each individual has a lifetime allocation of a loan limit of about 100,000 Australian dollars, which they can dip into throughout their life. Do you think that something like that might help to drive the sort of lifetime learning that most businesses I am engaged with think their employees need to start to grab hold of?

Dr Philippa Lloyd: We are looking at what we call career learning. At the end of October, we launched one of our career learning pilots—the flexible learning fund—to work with both employers and providers to identify the barriers to getting adults back into a classroom, and to look at innovative ways of delivering. We will be doing a pilot on affordability, as well, to look at issues of that sort. I hesitate to use the term "individual learning accounts", which is what you were describing, as it brings people out in an allergic rash, given where they got to previously, but we will look at affordability and outreach and delivery models. The Government are committed to introducing a national retraining scheme to promote career learning.

Baroness Harding of Winscombe: What is the timing for those trials and pilots?

Dr Philippa Lloyd: We announced one pilot, on flexible learning, at the end of October. That was last week; I am already galloping towards Christmas in my mind. The other one will be announced shortly.

The Chairman: A week is a long time in politics. Sadly, we have run out of time. You will be very disappointed to hear that we have not had time to ask you our questions about student loans.

Dr Philippa Lloyd: The Treasury is coming. You can ask them.

The Chairman: We will write to you with the questions, if we may. Thank you very much for a most informative session.

Baroness Kingsmill: If you felt like writing anything about your feelings on value for money, I would really appreciate that.

Dr Philippa Lloyd: We will.

The Chairman: Thank you very much.

Examination of witnesses

James Bowler and Charles Roxburgh.

The Chairman: Mr Bowler and Mr Roxburgh, welcome to the Committee. Lord Turnbull will put the first question.

Q49 **Lord Turnbull:** We had a memorandum from the Department for Education that set out some principles for what a system of student finance should have as its base: providing resources to sustain our education system; fairly sharing costs between the general taxpayer and students or graduates; sharing the cost fairly between graduates who earn well and those who do not; and removing barriers to access. There is quite a lot of consensus that those are pretty sound principles, but what has been represented to us is that, somehow or other, we have managed to turn some of those sound principles into something completely toxic, to the extent that the Government have to scramble to try to detoxify the system.

There are a number of variables. The question is whether, when you add all of them up, you think this thing has been overegged. There is calling it debt, which makes it look a lot more frightening than it is; there was an attempt to freeze the threshold, but that did not last; people cannot understand why the interest rate can possibly be 6.1%; there is a repayment rate of 9%, which is the only variable that has not changed; and there is the conversion of grants into loans. When you take it in aggregate, a lot of people are frightened by it. It is not as bad for students and graduates as it looks, but it has an appalling appearance.

The Chairman: We start with an easy one. Discuss.

James Bowler: I am James Bowler, head of public spending in the Treasury. I see quite a lot of issues in that question. At the Conservative Party conference, the Prime Minister, as well as announcing an increase in the threshold, announced a review of the system, and perhaps she had in mind many of those issues.

The particular points I would pick out from the areas you mention are people's understanding of the system and the communication of it; people focus a lot on the interest but are perhaps less clear about the threshold; and they focus particularly on debt but perhaps are less clear on the write-offs that occur in the system. The thresholds and the write-offs are the subsidy elements in the system, and arguably are not as well understood as they might be. As to outcomes, one-third of 18 year-olds are going into higher education—the highest level ever and it has gone up considerably—and 43% more disadvantaged people went into higher education in 2016 compared with 2009. You could argue that the outcomes of the system are delivering, but there is a lot to unpack.

Lord Turnbull: One of the attempts was to make the system more progressive, and I think that lies behind the choice of interest rate. The effect of it is to increase debt. Last week, we looked at the Australian system, where the repayment rate rises but does not go to 9%; it never gets higher than 8%. The question is whether it would have been better to have a tranche with a repayment rate at a lower level and then a tranche at a higher level, so that at least people had a better idea of what they would repay at certain levels of income.

James Bowler: There are two elements of progressivity in the structure of the system as a whole and in the changes under successive Governments with the move to student loans. There is the structure of increasing graduate contribution compared with the general taxpayer picking up the entirety of the bill. We could argue that that is progressive, if the statistics I have are correct—that over their lifetime men earn on average £170,000 more from going into higher education and women £250,000 more. That is the first progressive element in the structure of the system.

The second element of progression is the interest rate itself. The more you earn, the more you pay, and, if you do not earn more than the now increasing threshold, you do not pay anything at all. I come back to my remarks in response to your first question. There are elements in communicating the system that some people struggle with.

The Chairman: Mr Roxburgh, do you have anything to say on this?

Charles Roxburgh: No, thank you. James has answered it pretty well.

Lord Turnbull: One accusation is that the system is too greedy and not explained. Another is that a number of changes have been made not because they produce the best result for education, but because they make your accounts look better. The interest rate is clearly one of them. You score it as income and 20 years later you write off a lot of it. The switch from maintenance grants to loans is exactly the same. A lot of people think that should be reconsidered. You make the speed of reduction of the deficit look particularly good, and 20 years down the line you write it all off. That would not necessarily be the best design of the system if you were not paying quite so much attention to the cosmetics.

James Bowler: I would refute that. On the accounting front, our hands are tied. We follow national accounts; ESA 10 is an international standard. When you follow national accounts, there are some snakes and ladders in the system, as you will be only too aware. You must follow them and you cannot pick and choose when you do and when you do not. We follow them, which means that interest scores as a reduction in PSNB when it accrues. You are right that the write-offs come in only at the end of their term, but explicitly to allow for that we have a budgeting system that ensures that the DfE reports on its expectation of those write-offs every year. It reports both on its balance sheet and through the RAB charge—the impairment charge—which I think you have already heard about.

When you move from general taxation to a loan system, there is more complicated accounting and it is over a period of 30 years, but in the balance sheet that we publish and, complementary to that, the budgeting system we produce, we have tried to make sure that there are incentives to manage the assets sensibly, and that we are fully transparent in what we are doing.

Lord Burns: To take up the issue of progressivity, there are some differences in the evidence we have received. It is commonplace to say that the system is progressive because of the threshold and so on, but it was pointed out in evidence a couple of weeks ago that that is not necessarily the case all the way up the income levels, because people who pay it all off earlier end up paying less. Is it not a much more complicated thing than is often said? It is clearly progressive from an income level of £20,000 up to, say, £40,000, but beyond £40,000 it does not appear to be progressive at all; if anything, it may well be regressive, because those people pay it off earlier, so the higher the interest rate, the less it affects them. Is that something that falls in your watch?

James Bowler: Dealing with public spending, I am the proud owner of virtually everything in my watch, but it is a progressive system. There are two elements: you do not have to take out a loan at all, and you can pay it back whenever you want. As part of the consultation on the system, the coalition, with enthusiasm from the Liberal Democrats, consulted in 2011 on having an early repayment charge, but there was very negative feedback—that it might put people off going into the system at all.

Is it progressive? I recognise that the Treasury quotes the IFS when it likes it and does not when it does not, but the IFS says that if you are in the top decile you will pay back £93,000 with the interest rates now, but if you did not have RPI plus 3% but CPI plus 0% you would pay back £53,000, so that is progressive. If you are in the system, the more you earn, the more you pay; but if you do not even get above the threshold, you do not pay anything. By the standards of progressivity in government, that is pretty progressive.

Lord Burns: At some point, I would like somehow to get to the bottom of this with a proper piece of analysis. It is clearly progressive between about £20,000 and the point at which somebody pays it all off, which I think is round about £40,000 to £45,000. After that, because you have paid it off when you get to that level, higher income simply means that you are paying it all off earlier. The system ceases to be progressive from that point on and may even be regressive.

James Bowler: The fact is that the interest rate is RPI up to the threshold, and then it is RPI plus between 0% and 3% between the threshold, which at the moment is £21,000, and £41,000, so there is a taper. As you say, there is a 9% repayment above that. It is locked on to a progressive income tax system, which some would argue is getting more and more progressive at the top end. That was my last job.

The Chairman: Is the answer to Lord Burns's question yes?

Lord Burns: Who will give us a piece of evidence which will satisfy all the parties about just what happens as you go up the income scale under these arrangements? I am quite confused.

James Bowler: It is progressive, but we can certainly provide you with that.

The Chairman: But the point Lord Burns made is correct, is it not?

James Bowler: The taper goes from RPI plus 0% to 3% between what will be £25,000 and £45,000, and stays constant thereafter.

The Chairman: You are describing the system, but the point Lord Burns makes is that it is not progressive for people who are beyond £40,000. Is that correct?

James Bowler: Yes, to the same extent that the UK tax system is not progressive above 45%.

Baroness Kingsmill: Mr Bowler, who pays if you do not take out a loan?

James Bowler: You are not required to; the answer is that you pay yourself.

Baroness Kingsmill: Do a large number of students do that?

James Bowler: I do not have the evidence.

Q50 **Baroness Harding of Winscombe:** Can we talk about the student loan book? It is interesting for us properly to understand the reason for selling any element of the student loan book, aside from the Government's preference for cash today. Is there any economic logic beyond that?

Charles Roxburgh: The Government have the very clear policy that they hold assets only when there is a good policy reason for doing so. If there is not a policy reason for holding an asset and they can sell it and realise value for money, there are better uses to which they can put their balance sheet. The policy purpose of providing a student loan is to enable that student to go to university and get their education, so once they have left the policy purpose has been satisfied. The question then is whether we should hold that asset on our balance sheet or sell it at a price that realises value for money for the taxpayer and, given that we have finite balance sheet capacity, put that capacity to other uses with assets that serve a better public policy purpose, as the student loan policy purpose has been concluded. If we can sell it and realise value for money, the Government would choose to do so.

Baroness Harding of Winscombe: Why is funding students' education not a core purpose?

Charles Roxburgh: The purpose has been achieved when the student has received that education, graduated and gone into the labour market. At the moment, the Government are selling some of the so-called plan 1 loans. Those are all pre-2012. Those students have graduated and those in the labour force are earning, and the loans have served their public policy purpose of helping them to get their education.

Lord Darling of Roulanish: You said there was a policy reason for selling the loan book. The Government have been considering selling the loans for about a year. What was the policy reason for announcing the sale three weeks before the Budget?

Charles Roxburgh: The sale was announced initially before the election in spring this year and was put on pause during the election period under purdah rules. The decision was taken to restart it at the appropriate point. We needed to get more data. The loans had been through a renewal of data. The data we had for the loans as they were for a sale beginning at the end of May needed to be refreshed with a new set of data. Once that was ready and we had the approvals, we started the loan sale.

Lord Darling of Roulanish: From what the Universities Minister said last week, I understand that the terms and conditions are not yet finalised. Is that correct?

Charles Roxburgh: It is a sale process. We are going through the process of developing bids and building the books, and we will know the final price at the end of that sale process, so to that extent the price is not yet determined.

Lord Darling of Roulanish: Is it scored in public expenditure terms when the thing is completed, or can you do that now?

Charles Roxburgh: I cannot comment on what the OBR will do for the Budget process coming forward. In the past year, the OBR has scored student loan sales, but we will need to see what it does when we get to the Budget.

Lord Darling of Roulanish: When does it score them? Is it at this stage, when they are announced, or whenever it is finally resolved?

Charles Roxburgh: In the past, this is how the OBR has treated a number of asset sales. I obviously cannot comment on the current OBR forecast, but in the past, when the OBR believes there is sufficient certainty that the asset sale will go ahead, it has scored asset sales for the forecast period. Its view is to take the best possible estimate of how the public finances will look. If there is a strong case that those loans will go ahead and we can provide evidence with sufficient certainty as to what pricing will be, it will score them. I cannot comment on what it will do this time, because that is for the upcoming Budget.

Baroness Harding of Winscombe: What warranties and indemnities do you expect to have to give?

Charles Roxburgh: There are four types of warranty. The first category is what we call full repurchase. That is a set of commitments to repurchase the loans if certain things happen that are in government control: for example, if HMRC, or its future equivalent, ceased to collect the repayments, or if RPI was abolished and there was no replacement. Those are things that we think are very remote, but as an investor you would want to make sure that HMRC continued to collect the repayments. Were that to stop, we make a commitment that in specified events we would buy back the loans.

There is a category of significant servicing events. One of the conditions of the sale is that the servicing stays with the Student Loans Company. For other securitisations, investors can switch servicer. In this case they cannot; it stays with the servicing company. If there is a failure of that servicing, and as a result the investors lose income, as they do not have the option of exiting those arrangements we have a warranty to make that good. We have that liability now whether we sell or keep the loans. It is not an incremental liability, but it is a reasonable commitment to give investors that, if the Student Loans Company fails in its servicing obligations, they are made good.

There is a thing called the compensation mechanism. Again, because investors do not have the right to change the terms of the loan—the loan terms remain with Government—were Government to change the terms of the loan, the investors would be compensated for that. This Government have made it clear that they are not considering any changes to the plan 1 loan terms, but they cannot bind future Governments. Investors have no control over the loan terms, so in order to make it a reasonable transaction they would be protected if the terms were to change.

Finally, there is a set of standard indemnities that cover things in any securitisation issue, around misrepresentation, misleading statements, omissions or a breach of duty by the Government. That is standard for any sale of this nature.

Baroness Harding of Winscombe: It is not hard to see why students and parents are scared of these products; their loan can be sold to another entity and the Government warrant to the purchaser if they change the terms of the loan, but for the student the terms of the loan could change at some stage in the future. How do you square the circle that all you are really trying to do is get short-term cash on to the Government's balance sheet, and you have to offer a big compensation mechanism to a potential purchaser, which serves to reinforce the lack of confidence students have in the system?

Charles Roxburgh: One point I would stress, which links back to Lord Turnbull's point about communications, is that it is very important that we continue to communicate very clearly that this sale will have no impact on the people whose loans are sold. The investors cannot change the terms of the loan; they cannot change the servicer; and there is no change in HMRC's role in collecting the repayments. This has no effect on the student or graduate whose loan has been sold. You talked about people being confused and scared. There is no reason for them to be scared, because the sale of the loan has no impact on them. That is how the process has been designed.

Lord Sharkey: The only reason to be scared is the Government. If the Government change retrospectively the terms of the agreement, that is a reason to be scared.

Charles Roxburgh: This or any future Government can change the loan terms whether they are on or off the balance sheet, so the sale makes no difference to that. On the sale currently under way, this Government have made it clear that they are not considering making changes to the plan 1 term conditions.

The Chairman: I looked at the Written Statement by Jo Johnson in which he said that the sale would proceed "subject to market conditions and a final value for money assessment". The Treasury's value for money test uses a discount rate of RPI plus 3.5%. The reduction in the discount rate for student loans at RPI plus 0.7% means that the Government could make a substantial loss on the sale against the value they place on the loans, yet it would still pass a value for money test. Can you explain why that makes sense?

Charles Roxburgh: We look at value for money by using the standard green book methodology to assess the discount rate.

The Chairman: I understand that.

Charles Roxburgh: We look at the value of the loans if we retain them, discounting the cash flows. That is the retention value, and we compare that with the price we are going to get in the market. We also want to make sure that there has been a competitive process, so that we have confidence that there has been an appropriate level of bidding by market participants and an efficient market. If the price we can realise in the market is higher than the value of holding them, it will pass the value for money test. It is not whether or not we score a gain; it is the economic value of holding versus the price we can get on a sale.

The Chairman: You do not think the discount rate is too high.

Charles Roxburgh: The green book discount rate reflects the opportunity costs, and we use it for all our assets. The issue we face in managing the Government's balance sheet is that we have a finite capacity, so we have to look at all the different claims on that balance sheet for new projects. The green book methodology tries to look at them on the basis of opportunity cost independently of how we fund them. We do not look at the gilts rate; we look at the opportunity cost. The rate is arrived at by a lot of study, with academic input, as to the opportunity cost of using that capacity on our balance sheet for that type of asset, as opposed to another type of asset. If we sell the loans and get value for money, we can use that balance sheet capacity for other projects, which would have to meet the same hurdle and would, we hope, have a higher return and achieve a better policy outcome. It is about making the best use of our finite balance sheet capacity.

The Chairman: You do not agree with the editorial in the *Financial Times*: "The decision to sell the student loan book is not a huge fiscal issue. But it does reveal one: the approach being taken to management of the government's balance sheet creates pressures to make silly decisions. Change it".

Charles Roxburgh: We would not go ahead with the sale if we were not getting value for money. I do not agree that it is a silly decision if we can realise value for money.

Lord Sharkey: Can I return to the 9% repayment rate and ask two questions about it? Why 9%? Is there a case for reducing the headline repayment rate and extending the repayment period?

James Bowler: There are three elements to the package that go together: the interest rate, the threshold and the term. The current position, which came out of the Browne review and went into the 2012 reforms, represents a reasonable balance of those three. You can change one or other of the elements, and increase or reduce the subsidy from the general taxpayer to students as much as you can. The decision by the Prime Minister to increase the threshold increases that subsidy to the system. When you are doing it, you need to look at each of the three elements.

Lord Sharkey: I am sure that is the case, but my question is about whether, by adjusting the 9% and the period of repayment, you can make the system more genuinely progressive than it currently is. The Prime Minister's change will cost per cohort about £2.3 billion, according to the IFS. Quite a lot of money is involved. Would there be a way of adjusting the repayment rate and the repayment period to make the system more obviously progressive? I know we have not yet seen your chart.

James Bowler: Increasing the threshold benefits about 600,000 borrowers and is worth about £360; it reduces the value of the loan book and increases the subsidy that general taxation is putting into the system. You could increase the 9% or the term. People could pay for longer. You could do all of those things. I do not think any of them is potentially better than the other.

Lord Sharkey: Surely, one must be better than the other; otherwise, you would not have chosen 9%. I understood your first answer to mean that 9% was the optimum figure.

James Bowler: That was the balance of the system that came out of the Browne report. I do not think there are any plans to change that figure.

Lord Sharkey: I will press the point once more. My question is to do with whether or not the system as designed, with the 9% and the current repayment period, will produce a more progressive system than any alternative of the three variables you talked about earlier.

James Bowler: I could not consider a more progressive system now. The more you increase the threshold, the less people pay at all. Increasing the threshold is probably one of the most progressive things you can do. If the progression you are after is to reduce the number of low earners paying anything, that is probably the most progressive of the three elements or levers you can pull.

Lord Sharkey: I understood that. If it were 7% and longer, would that produce a more progressive system than the one we have?

James Bowler: I do not know the answer to that.

Lord Sharkey: Surely, there is an answer to these considerations. The fact is that it is at 9% over a period of years. You have chosen that; it comes out of the Browne review, but is there a better combination of those two figures that will produce a more progressive system?

James Bowler: Progression is not a single measurement. It depends on how you want to trade it off. If you wanted more people to pay something, you would extend the term longer and longer; if you wanted people, while they are in the system, before write-off, to pay less, you would reduce the 9% to 7%. There is no clear-cut judgment as to which is better; it depends on your preferences and whether you want more people paying a smaller amount or fewer people paying a larger amount.

Lord Turnbull: At what stage of their lives are they paying this money? It seems to me pretty tough if a newly qualified teacher comes in at £20,000, and by the time they are 30 and have possibly started a family they come straight into this thing at 9%. One of the merits of the proposal Lord Sharkey is making is that quite a lot of people would much prefer not to pay this at a time when the financial pressures in their lives are at their greatest, but to pay it when they are better established in their career.

James Bowler: That is a perfectly good argument. Smaller and longer is a preference to higher and shorter. Of course, the term has increased from 25 to 30 years between plan 1 and plan 2. The other point to chuck in is that the personal allowance has gone up from £6,500 to £11,500 in that time, so 4 million income tax payers are taken out of income tax altogether, and on those kinds of figures people are paying considerably less income tax than they were seven years ago.

Baroness Harding of Winscombe: Is not the irony that we have a system that, looked at technically, is very clever, and at least is providing some degree of progressive charging, but we have conspired to call it a loan when it is not, which has scared people; it has very large amounts of money called a loan, which scares them even more, with a notional interest rate that is very high and feels unfair, whereas when you probe it, the mechanics of the system are not far off being sensible? Last week, we heard about the Australian system. Its basic dynamics are not that different, yet society there is not up in arms about it. The Australians have not called it a loan. They pay more over a shorter period of time, but there is no interest charge, so I guess it feels fairer, and the total loan is smaller. It is another way of asking Lord Sharkey's question. Fundamentally, we have the right levers, but we have set them at the wrong level and conspired to create something that ought to work and is causing tremendous dissatisfaction.

Charles Roxburgh: There is a huge difference between these loans and commercial loans. If you do not have a job, you do not have to pay it back; if you do not earn above the threshold, you do not have to pay it back, and it gets forgiven after the end of the time. Compared with any commercial loan it is a very different creature, but there is a communications point.

Lord Sharkey: I think we misunderstand the view that many people will take about a sum of money that is informally called a loan. Most normal people cannot pronounce the words "income-contingent loans".

Charles Roxburgh: Communication of this is critically important.

The Chairman: How do you think you are doing on that?

Charles Roxburgh: We need to do better in communicating what the true nature of the system is. It has become very complicated, so it is incumbent on policy officials, Ministers, commentators and this Committee to help communicate its true substance.

James Bowler: I am sure all of this was in the Prime Minister's mind when she announced the review, which I know the Committee has been talking about as well. You could add to the list that there seems to be a view that it is some kind of commercial loan, which clearly it is not. As Jo

Johnson said in his speech in the summer, it is 65% graduate contribution and 35% general taxpayer contribution. You certainly could not get anything like those terms from the commercial market in any way, shape or form. If we are unable to communicate that, it is a frustration. In particular, the level of write-offs is not well understood.

The Chairman: There seems to be different emphasis in the language about the review. What is the position on the review? Has it started? When is it going to be completed? I have seen quotes from the higher education Minister saying the system is being kept under review, which is quite different from having a review. What is actually happening on this review?

James Bowler: It was announced recently. The terms of reference have not been produced, and we need to do that. I cannot tell you a lot more about it.

The Chairman: Would it be unkind to say that nothing is happening on the review?

James Bowler: The Government announced it a few weeks ago, and now they need to set out how they intend to conduct it.

The Chairman: Is there an idea of the timescale?

James Bowler: It is not a Treasury announcement.

The Chairman: I am sure the Treasury has a view.

James Bowler: The Treasury does have a view.

The Chairman: Do you want to share it with us?

James Bowler: The Treasury will be looking at value for money in the use of public spending as part of that.

Q51 **Lord Layard:** We are worried about the balance between higher and further education, and the apparent underfunding of further education relative to higher education. As we have just been discussing, we are also worried about all the fictions around the way higher education is funded. If the truth about the funding of higher education was revealed by a more sensible interpretation of actual cash flows—cash flow out when the loan is made and cash flow in when the student starts paying it back—and we looked at those magnitudes, rather than the accounting magnitudes, would we find it more difficult to find money for further education? I am just putting that to you as an issue. Is it not an advantage to have all those fictions, in the sense that, if they were removed, you would either have to cut down the funding of higher education or have nothing left for FE?

James Bowler: I noted the debate the Committee has been having on FE, and the question as to whether the very large increase in people going into higher education is indeed the best route for every single person. I think that when the Chancellor was giving you evidence he reflected on that. I do not think it is a straight quid pro quo in the public spending system that the more you spend on HE, the less you have to spend on FE. The Government are undertaking training and skills funding in various guises, be it T-levels or the apprenticeship levy in work, to try to increase funding in those areas.

The DfE balance sheet tells you the cash flow in and out at any one time. We have set up a budgeting framework to show very specifically and be transparent about what is actually happening, but I very much take the point Lord Layard is raising about whether the large increase in numbers going to HE comes at the cost of FE. It is an important part of the debate.

Lord Layard: The thought occurs to me that if we want to get a better deal for FE it would be more public expenditure, but maybe that, too, can be achieved under the fictional system. Maybe FE should receive the same fictional treatment as universities.

James Bowler: I do not think there are plans to do that.

Lord Layard: There have been discussions as to whether there should be more loans to FE students and so on. Rather than suggesting more public expenditure on FE, would it not be helpful to you if we were to think about ways of funding FE in the same way as universities? It would help you with the presentation of your accounts.

James Bowler: I would not characterise the funding of FE as an elaborate system to help us with the presentation of our accounts; it is a system to move some of the financing of many more people going to HE towards a graduate contribution, reflecting the fact that graduates are on average earning much more in their lifetime by going to HE. The purpose of the reforms is that they contribute directly to the costs of their education rather than it just being the general taxpayer. Before, it is arguable that people earning far less than graduates going through the system paid a large amount for people who benefited from the system, so I do not characterise it in that way. There must be a case for looking at ways of increasing funding for FE. I mentioned a couple of things that the Government are looking at to try to increase FE training at vocational level through T-levels, and in the workplace through the apprenticeship levy.

Q52 **Baroness Bowles of Berkhamsted:** The policy objective of student loans is to get students to go to university, so that as many as want to go can go; there is no cap. Does there come a point at which that is in conflict with the Treasury's objective to try to control public spending? I understand that you have a certain amount of recycling when you get into the selling of the loans, but meanwhile, if there is an ever expanding number, the balance sheet is ever expanding. Is there a point at which you have to reintroduce the cap in some way?

James Bowler: I do not think there is any intention to introduce a cap. The 2012 reforms looked at the balance between wanting to expand numbers rapidly and still keeping public finances under control in two ways. The first was by delivering a graduate contribution. There is a potential unfairness; if you expand the number of graduates rapidly but pay for them solely through general taxation, you get the impact I was referring to. People paying taxation will not necessarily get the benefits of higher education, so there is unfairness.

Secondly, in our budgeting system, we make sure that we are absolutely clear as to what subsidy there is in the system both through what we put in our balance sheet and how we use our budgetary framework. In particular, the total of plan 1 and plan 2 loans on the balance sheet is about £89 billion at the moment, and we record some £27.5 billion of impairment. That is a subsidy going into the system at any one time. It is very visible. The Government of the day need to consider whether they can afford that subsidy, or whether they want to increase or decrease it. Recently, the Prime Minister decided to increase it. The framework monitors very closely the balance between higher student numbers and the impact on the public finances. Of course, the whole thing starts by moving to a graduate contribution to allow those numbers to increase, and increase they have, very dramatically, as part of getting rid of the cap on numbers.

Charles Roxburgh: The plan to sell loans enables us to allow for more people to go over time, because, if we did not sell any, the forecast is that we would end up with about 10% of GDP represented by the student loans held on the balance sheet. Alternatively, we can turn this into an asset class that we can sell on while not changing the conditions for students. That means we do not take up as much balance sheet capacity, for the same amount of public policy benefit—students going to university, getting the education, going into the workforce with greater skills and, therefore, driving up productivity. I argue that the outcome is not going to university; it is getting a good university education, and then going into the workforce with higher skills and being able to command a graduate premium for work and sustaining that.

Baroness Bowles of Berkhamsted: I understand that. Do you think there comes a point when you have more and more people going to university—there is also concern about whether they are getting value for money—and the graduate premium ceases to exist? If we have so many graduates that the premium ceases to exist, the amount you have in the impairment will go up. What analysis have you made of that?

James Bowler: I do not have a point to give you where there is a cross-over, but the people giving evidence before us were talking about the kind of changes made through the Higher Education and Research Act this year—the establishment of the Office for Students and the teaching excellence framework. That is all about value for money in the system, making sure that the impact of teaching on earnings is clear in the ranking in the teaching excellence framework, and that the Office for Students brings value for money and efficiency to the system. I do not think it answers your question directly, but there is a subsidy and public spending element and a regulatory element to make sure that you are getting value for money from the system.

Baroness Bowles of Berkhamsted: If the regulatory element did not work because so many were going, would there come a point at which the Treasury had to step in and say it cannot take that level of impairment so there has to be a cap in order to reintroduce, in a sense, the graduate premium?

James Bowler: You would keep it under review. The way we currently operate the budgeting system is that we have a target for what we think is an acceptable level of impairment, which is currently 36%. The current level being achieved is 30%, so that is an indication that we do not think the system is under stress.

Lord Sharkey: Is there a Treasury model that tells you the point at which take-up and the graduate premium cancel each other out? Clearly, if the number of people going to university went up to 100%, the graduate premium would not exist. Is there a model that tells you where the cross-over point is?

James Bowler: I am not aware of a model that does that. DfE runs a very complicated model to calculate its RAB charge each year. That includes a set of complicated assumptions about future earnings from going to higher education. It runs off the OBR's forecast for earnings but includes what it thinks is the premium. I do not think there is a Treasury model, but in DfE there is a very complicated model of the impact, which it uses to calculate and publish what it thinks is the subsidy in the system, which is essentially the RAB charge. It is not in the Treasury but it is in DfE, and we have full sight of that model.

The Chairman: I am a bit muddled about this. You were talking about an RAB target of 36%, but the other day Jo Johnson said that the RAB charge was now estimated at between 40% and 45% as a result of the changes.

James Bowler: That is absolutely correct. Perhaps I can explain it; it is pretty complicated.

The Chairman: We will brace ourselves.

James Bowler: Strap yourselves in. We set an RAB target as the incentive for DfE to manage this asset sensibly. At the moment, that target is 36%, and the actual level of RAB charge DfE is achieving is 30%; the target is 36% and the level is 30%. The increase in the threshold announced at the Conservative Party conference reduces the value of the loan book and increases the subsidy in the system and, therefore, increases the RAB charge. Jo Johnson told you that he expects the 30% it is currently achieving to increase to between 40% and 45%. The target is currently 36%, and in the PQ he gave the expectation that the actual level it is achieving of 30% will increase to between 40% and 45%. I hope that explains it.

Lord Burns: Am I right in concluding as regards behaviour so far that, when it turns out that the RAB charge has increased beyond what was expected, the terms of the loans will have been tightened, and you will hold open the option of tightening them further in the future, if it turns out that the economy and earnings grow less rapidly, or there are other things that mean that the value of the loan book declines? You have that option, do you not?

James Bowler: We are limited by what Parliament has agreed, but you are right. The terms and conditions apply at the time. When the thresholds were frozen, there was debate about whether that was changing things retrospectively. You might have had that debate in this Committee. The answer was that Parliament had not included indexation of the threshold within regulations, and the terms and conditions are that whatever regulations applies at the time applies.

Lord Burns: And that it can change.

James Bowler: Yes.

Lord Burns: In the years when I was involved in banking, I observed a whole series of attempts, by and large successful, by the Financial Conduct Authority to follow its policy of treating customers fairly: people should be quite clear about the terms when they take on a loan; the information provided to them should be quite clear; and there is no retrospection—once you agree a set of terms, it is followed through. The Treasury has some responsibilities in that area. Do you feel any pangs of guilt at the fact that you are operating a system with regard to student loans that is so far removed from the requirements you place on private sector financial companies when dealing with their customers? It is not only about being allowed to change it but, as we have heard repeatedly in these sessions, about people's lack of understanding of just what the system is.

The public perception is that people do not know how far the terms may change in the future, because it is very long term, and they certainly do not understand the present system. As Lord Turnbull pointed out earlier, the terms used appear to suggest that the system is rather close in some respects to a private sector loan agreement, yet, as we hear repeatedly, it bears no relationship to it in practice. Is this not part of the lack of confidence and people's concern about the system? We have something that is described in one way; it is impossible to understand; and it is far adrift of what people understand by the sort of terms and conditions they would expect to be dealing with.

James Bowler: I think we have agreed in the course of the evidence session that communication is not as good as it could be. I will not add to that.

I repeat in strong terms that this is in no form a commercial loan, for a whole host of reasons: there is no security; there is a threshold; and you get a write-off, which is very much not on offer in the commercial world.

The Bank of England unsecured interest rate is about 7% or 8% at the moment, so even the interest rate is lower than that.

As to how the system operates, it has gone through Parliament. The terms and conditions specify that repayment terms are subject to regulations at the time. It sits on top of a tax system that I imagine will change over the next 30 years; obviously, political parties will change. The underlying reason for the system remains very sound; if we are to increase the number of people in higher education, should the general taxpayer pick up the bill for all of that, or should the graduate, who on average receives a considerable increase in their lifetime earnings, contribute? The complexity in the system comes from a desire to get that contribution, but not up front and only on the basis of ability to pay above a threshold, and obviously that requires terms currently of 30 years. That is a complexity. It is simpler to take it from general taxation straight up front, but not fairer.

Lord Burns: There are a number of us—I certainly count myself among them—who do not object to the principle behind the system, or what it is striving to achieve, or the notion of sharing the cost of higher education in the way it does. We are trying to get to grips with why something that started with good intentions, as Lord Turnbull pointed out, has ended up being so unpopular. As people have learned more about the complications, it has run into real problems, witness the Prime Minister's statement at the party conference.

James Bowler: I agree that people focus on interest, but not the threshold before they pay back. People focus on debt, and I particularly highlight to the Committee that the levels of write-off in the system are not well understood. It is understandable that when you take out a loan you have an expectation that you will have future earnings that will repay it, but the fact that there is a considerable safety net in the system that means you do not have to repay it if your earnings do not get above a certain level, or you go out of the labour market for a certain period of time, is perhaps not well understood. As Jo Johnson said in his speech in the summer, there is a 65% graduate contribution and 35% government contribution. People think it is 100% and 0%.

Q53 **Lord Turnbull:** You describe a control system in which you have an RAB target, and if it looks as though it will go above that you harden the terms, and when it goes below you weaken the terms. Presumably, in 2016, you took the opportunity to harden the terms and got the RAB down to 30%. The measure you took, which was the freezing of the threshold, has been thoroughly rejected; people thought that, apart from its being retrospective, it was harsh and unfair. Now it is up to 40%. What are you going to do? The one thing that is not plausible is that you can go back to freezing the threshold, so you have to find something else or recalibrate your target.

James Bowler: That is a good point. There are a few things. We set the target, and DfE assesses with its complicated model how it is doing against that target. The target has always been 36%; we have not changed it since its inception. The big change, not just the freezing of the threshold, was the 2015 alteration of the discount rate, because the discount rate was still at the 2006 level and did not reflect the changes in government borrowing thereafter.

We and DfE will look at whether the target will remain the same now that the threshold has gone up. There is a potential case for changing the target rate, given the decision to put more subsidy in the system. We have a decision to make as to whether we reflect that in the target rate, rather than change the policy immediately to counteract it.

Lord Sharkey: Is the Treasury involved in the work going on for the construction of a sharia-compliant student finance product?

James Bowler: Yes, it is. I am aware of it, although I am not aware of many of its details. I think it is being led by DfE.

The Chairman: Could you let the Committee have a note on it?

James Bowler: Certainly.

The Chairman: There is one very small question that puzzles me. For the purposes of student loans, why are you using RPI and not your favoured measure of inflation? Is it a coincidence that it acts to the disadvantage of the student?

James Bowler: RPI includes some things that are relevant to graduates, including council tax and mortgage interest, that CPI does not. RPI has been used consistently. We have talked repeatedly about elements of subsidy going up and down. You could use a different index, but whether you would then use the exact addition to that index if you changed index would be up to—you would not expect any other answer from the Treasury.

The Chairman: Thank you very much indeed, Mr Roxburgh and Mr Bowler. You have dealt with our questions admirably.