Labour's Zero-Based Review

Interim Report Number 7: Higher Education Funding

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Higher Education Funding

Foreword

The choice at this General Election is between the Tories' failing plan and Labour's better plan for working families.

The Tories' plan is failing working families because they chose to prioritise helping a few at the top. They just don't understand that Britain only succeeds when working families succeed. That's why Labour's plan offers a better future: for living standards and for the next generation.

Under the Tory-led Government life for the next generation is getting harder: university tuition fees have trebled and apprenticeships for young people fell in the last year.

We know what five more years of the Tories would bring because we've seen the last five years. Working people can't afford five more years of the Tories, with an economy that doesn't work for most people.

The policies of the Tory-led Government have saddled our young people with thousands of pounds more debt. And since the policy was designed the fundamental assumptions around the costing of the measure have changed. Back in 2010 ministers assumed around 30 per cent of student loans would be written off. But this figure has continually been revised upwards and now nearly half of loans are written off. This surpasses the figure of 48.6 per cent, the point at which the new system ends up costing the taxpayer more than the one it replaced.

This increase in the amount of debt set to be written off has been driven by the cost-of-living crisis as average earnings forecasts continue to be revised down. This failure is not simply an issue for young graduates – who are set to leave university with £44,000 of debt on average – it is a problem for all taxpayers who will be left to pick up the long-term costs of the Government's broken system. The figures in this report show how in 15 years' time the Government's student loan system will be adding £281 billion to net debt; and how by the mid to late-2040s student loans write offs will hit £21 billion a year as the first cohort of the new system have their outstanding loans written off.

Labour warned ministers that trebling fees would create huge new debts and raised concerns that many students would not be able to pay back their loans. The Tory-led Government has got its sums badly wrong and put the long-term sustainability of our public finances at risk as a result.

The next Labour Government will fix this broken system to ensure it is affordable for students, graduates and taxpayers as a whole. This document is intended to present an overview of the problems inherent in the current system and identify priorities for a future Labour Government.

Chuka Umuna MP, Shadow Secretary Of State for Business, Innovation and Skills
Chris Leslie MP, Shadow Chief Secretary to the Treasury

Labour's Zero-Based Review

BACKGROUND

The 'Zero-Based Review' is a root and branch review of every pound the Government spends and will help the next Labour Government to ruthlessly prioritise public spending and deliver service reform and improvements, rather than just salami-slicing budgets and watching services deteriorate as has been the practice under the Conservatives and Liberal Democrats.

This process is intended not only to reveal the current Government's costly errors and skewed priorities but will require the Labour Party to grasp opportunities to deliver reformed public services which are valued and justifiable; which provide value for money and quality services that meet the needs and demands of the public who use them; and which can both make savings, and secure economic growth.

Fundamentally reviewing current government spending is a necessary step in preparing for office. In 2013 Ed Balls MP, the Shadow Chancellor, announced that Labour would conduct a detailed review of every pound the Government spends, in order to help prepare ourselves for the challenges the next administration will face. We set out the principles of our Zero-Based Review in a Phase 1 discussion document in December 2013.

Since the start of 2014 Chris Leslie MP, Shadow Chief Secretary to the Treasury, has been examining detailed departmental expenditure as part of the first round of the Zero-Based Review, analysing every departmental budget and exploring public service reform and redesign in detail with each Shadow team. This process has been guided by the following five principles:

- We will use public money **more efficiently** – and seek efficiencies in every area of government spending

- We will use all departmental budgets to **strengthen the economy** – supporting growth, job creation, innovation and exports

- We will ensure **greater fairness** in the impact of spending – and will prioritise spending that prevents future problems

- At the same time as increasing efficiency, the **quality and experience of public service must improve** – offering the simplicity and responsiveness that people now expect

- We will strengthen **accountability and transparency** across government – with clear efficiency incentives for all departments

No department has been exempt from this process, including any areas that we may choose to protect or ring-fence, because efficiency will be necessary across all areas of spending.

Our work for Phase 1 of our Zero-Based Review has been informed by the wide range of work and reports which have contributed to the Labour Party's Policy Review: the Armitt Review of long-term infrastructure planning; the Cox Review into long-termism; the Small Business Taskforce; the

Wright Review into manufacturing; the Local Government Innovation Taskforce; and the Adonis Growth Review, to mention just a few.

Labour's Treasury team will continue to collaborate with Shadow Ministers to expose waste, mismanagement and poor decision making by David Cameron's Government, as well as increase the scrutiny of each departmental balance sheet over the months to come. We will complete our Zero-Based Review with our first Spending Review in government, but this early work is crucial to inform the policy choices we will make. As Ed Miliband and Ed Balls have outlined, the next Labour Government will be about big reforms and not big spending.

FAILURES OF THE TORY-LED APPROACH TO TUITION FEES

In 2010 the Tory-led Government decided to increase the cap on tuition fees to £9,000 from 2012-13 (an increase from £3,375 under the previous system). Other policies introduced alongside this increase in fees included:

- An increase in the earnings threshold above which loans begin to be repaid to £21,000. The threshold will rise in line with earnings and the proportion paid above the threshold will remain at 9 per cent
- Changes to the interest rate charged, moving from RPI only to RPI plus 3 per cent during study and then RPI plus 0 to 3 per cent thereafter depending on the graduate's earnings
- An extension to the period over which loans are due to 30 years post-graduation (rather than 25 years)
- Cuts in teaching grants, with grants for most subjects abolished[1]

Universities have seen their income per graduate increase by 28 per cent under the new system.[2]

The average fee for new full-time undergraduate students in England in 2015-16 is estimated to be around £8,700, or £8,600, once fee waivers are taken into account.[3] The introduction of £9,000 fees means that England is now estimated to have the second highest average fee level across all types of universities, with only the US higher.[4]

The Tory-led Government's tuition fees system is bad for graduates and bad for the UK's public finances as a whole.

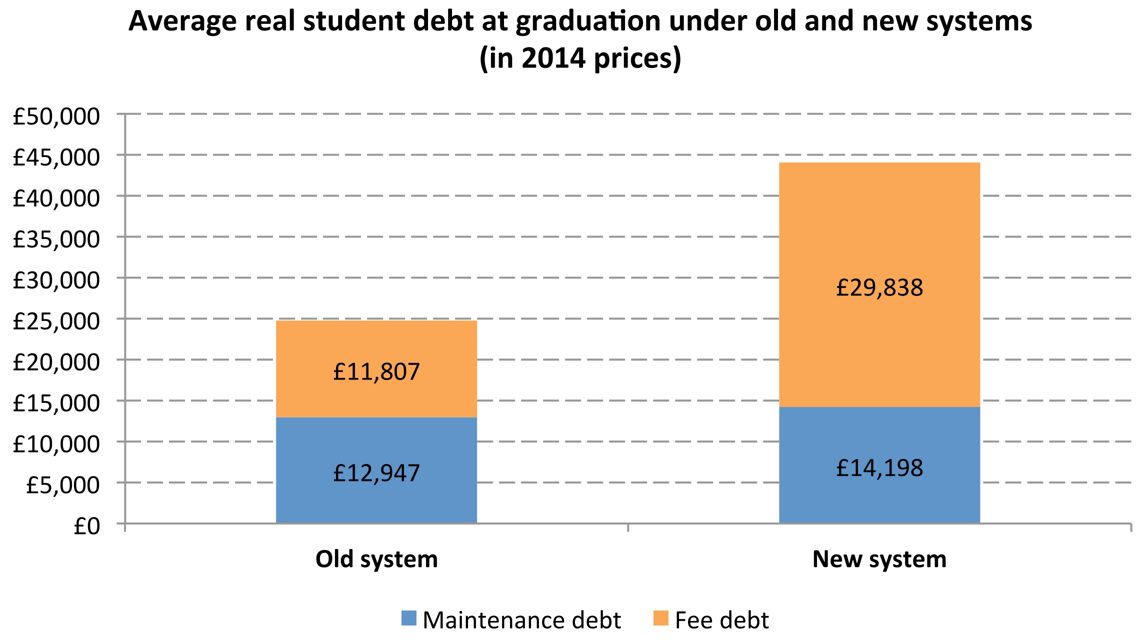
Tory fees system failure in numbers:

- The Government's student loans system will add £16 billion more to net debt by the end of the Parliament than was expected in 2013
- In 15 years' time (2030-31) it will be adding £281 billion to debt
- In the mid to late-2040s student loan write offs will hit £21 billion a year as the first cohort of the new system have their loans written off

[1] Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2014, p.169
[2] Institute for Fiscal Studies, *Estimating the public cost of student loans, April 2014*, Table B.2, p.66
[3] Office for Fair Access, *Access agreements for 2015-16: key statistics and analysis*, July 2014, Table 2
[4] House of Commons Library, *Tuition fee statistics*, 1 December 2014, p.13

IMPACT ON GRADUATES

The Government's decision to increase tuition fees to £9,000 means that, on average, students will now graduate with £44,000 of debt – around £20,000 more than under the previous system.[5] As research by the independent Institute for Fiscal Studies has shown, this increase in student debt is mostly driven by the increase in tuition fees, rather than maintenance loans.



Source: Institute for Fiscal Studies, Payback time? Student debt and loan repayments, April 2014, Figure 4.1

According to the IFS, the vast majority of students will never pay their loan back in full. Under the old system nearly half of all graduates would have repaid their loan in full by the time they were 40, but under the new system only around 5 per cent will achieve this.

Instead, almost three-quarters (73 per cent) of graduates will have some debt written off at the end of the repayment period, compared with 32 per cent under the old system. The average amount written off is estimated to be around £30,000. An average teacher (who works every year after graduation and whose earnings are equal to the average amongst their profession at each age), for example, will still owe £25,000 in their early fifties, at which point the remaining debt is written off.[6]

The Sutton Trust has warned that the Government's fees system means that many professionals, such as teachers, will have to find "up to £2,500 extra a year to service loans at a time when their children are still at school and family and mortgage costs are at their most pressing."[7]

[5] Sutton Trust, 10 April 2014
[6] Institute for Fiscal Studies, *Payback time? Student debt and loan repayments*, April 2014
[7] Sutton Trust, 10 April 2014

But the Government's system isn't just bad for those graduates faced with a debt burden they will never repay – it's bad for the public finances as well, in both the short-term and the longer-term.

IMPACT ON PUBLIC FINANCES

The cost-of-living crisis and the stagnation of wages have meant the Government has constantly had to revise its assessment of the cost of the new system.

In 2011 the Government estimated that around 30 per cent of post-2012 loans would not be repaid.[8] This is known as the 'Resource Accounting and Budgeting (RAB) charge". However by May 2013 this had risen to 35 per cent, and the Government now estimates it to be at least 46 per cent, although it has not updated this to reflect the latest Office for Budget Responsibility average wage figures.[9] The latest estimate of this by the House of Commons Library on the OBR figures estimates a RAB charge of 49.5 per cent. Ministers have been clear that the increasing RAB charge is the result of lower than expected forecasts for average earnings.

> "Every time there is a new lower estimate of earning growth that threshold becomes higher relative to average earnings, and Bahram is out on the media saying the RAB charge has risen. It is currently about 35% and whilst earnings continue to grow less than forecast in 2010 it could rise further. It will happen not because of any change in the value of going to university but **because of the impact of deviations of average earning from that 2010 forecas**t."
> *David Willetts, speech, 25 May 2013, https://www.gov.uk/government/speeches/david-willetts-minister-for-universities-and-science-hepi-conference-speech*

The Office for Budget Responsibility confirms this link, stating last year that changes in the forecasted RAB charge "mainly reflect updated assessments of the economic outlook, in particular lower earnings growth (linked with the much weaker-than-expected growth in productivity)."[10] In other words, the cost-of-living crisis is set to make it harder for the Government to recoup the costs of their expensive new system.

[8] David Willetts, Times Higher Education, 26 May 2011
[9] Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2014, Table B1, p.170
[10] Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2014, p.174

The Government has admitted – in answers to Parliamentary Questions – that a 5 per cent increase in the RAB charge costs the Exchequer around £500 million.

> **Mr Byrne**: To ask the Secretary of State for Business, Innovation and Skills (1) what effect an increase of the RAB charge of (a)one percentage point, (b) two percentage points and (c) five percentage points will have on the public sector finances in each of the five years from 2016-17; [178061]
> (2) if he will make an assessment of the potential effect of an increase in the RAB charge by (a) one, (b) two and (c) five percentage points on public sector finances in each of the five years from 2016-17. [178098]
> **Mr Willetts**: Estimates for the impact of RAB charge changes from 2016-17 are highly dependent on the future growth of earnings, and forecasts of spending for years beyond FY 2015-16 have not yet been made. However, the impact of 1% pt increase in the RAB charge on loans issued in 2014-15 would be around £100 million. The impact of 2% pts increase in the RAB charge on loans issued in 2014-15 would be around £200 million. **The impact of 5% pts increase in the RAB charge on loans issued in 2014-15 would be around £500 million.**
> Any change to the RAB charge will impact the net expenditure and balance sheet position in the Department for Business, Innovation and Skills annual accounts, but does not impact the current deficit or Public Sector Net Debt.
> *Hansard, written answer, 9 December 2013, Column 5W,*
> *http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm131209/text/131209w0001.htm#131209w0001.htm_wqn14*

The longer-term effect of the new system on the public finances is becoming increasingly clear. Analysis of figures published by the Office for Budget Responsibility last year found that the new loans system will add billions of pounds more than expected to government debt by the end of the next Parliament. This is because graduates are now expected to pay back less of their tuition fee loans than the OBR previously thought. Lower repayments by graduates mean that the Government gets back less of the loans they have made, adding to government debt. Reasons for this increase include a rise in the proportion of graduates on low pay, as well as more students taking up the loans.

A comparison of the OBR's most recent projection of the contribution of student loans to public sector net debt with that made in 2013 found that the new student fee system brought in from 2012 is now expected to add an extra £16 billion more than previously thought to public sector net debt by the end of the next Parliament.

Contribution of Student Loans to Public Sector Net Debt from post-2012 Student Fee System

	2015-16	2016-17	2017-18	2018-19	2019-20
OBR Projection July 2013	£26bn	£37bn	£49bn	£62bn	£75bn
OBR Projection July 2014	£30bn	£45bn	£59bn	£74bn	£91bn
Difference	£4bn	£8bn	£10bn	£13bn	£16bn

Source: Office for Budget Responsibility, Fiscal Sustainability Report, July 2014, Chart B.1; House of Commons Library analysis

RAB charge – a history

The Resource and Accounting Budget charge is the estimate of the amount of loans which are never repaid and any differential between the interest rate charged and the Government's cost of borrowing.[11] It has changed radically since the Government's tuition fees policy was first announced and when compared with the previous system. Much of this has been driven by weaker than expected average earnings:

- **Old system:** The RAB charge under the old fees system was estimated to be 28 per cent[12]
- **January 2011:** Universities Minister David Willetts states that ministers estimate the RAB charge will be "around 30 per cent overall"[13]
- **June 2011:** The Government's impact assessment estimates that the RAB charge under the new system will be 32 per cent[14]
- **July 2013**: Willetts states that "macroeconomic conditions" have increased the RAB charge to 35 per cent[15]
- **December 2013**: Willetts states that the RAB charge has been revised "in light of new earnings data and other factors" and is currently around 40 per cent[16]
- **March 2014**: Willetts states that the RAB charge is estimated to be "around 45 per cent", noting that it is "highly dependent" on the growth of graduate earnings over the next 30 years[17]
- **July 2014**: The Office for Budget Responsibility estimates the RAB charge to be 46 per cent[18]
- **January 2015:** Updated calculations from the House of Commons Library, based on the latest OBR figures, estimate the RAB charge as reaching 49.5 per cent [19]

It has been estimated that a RAB charge of 48.6 per cent is the level at which the gains to the Exchequer of a higher level of fees are wiped out[20] – in other words the new system becomes more expensive than the structure it replaced.

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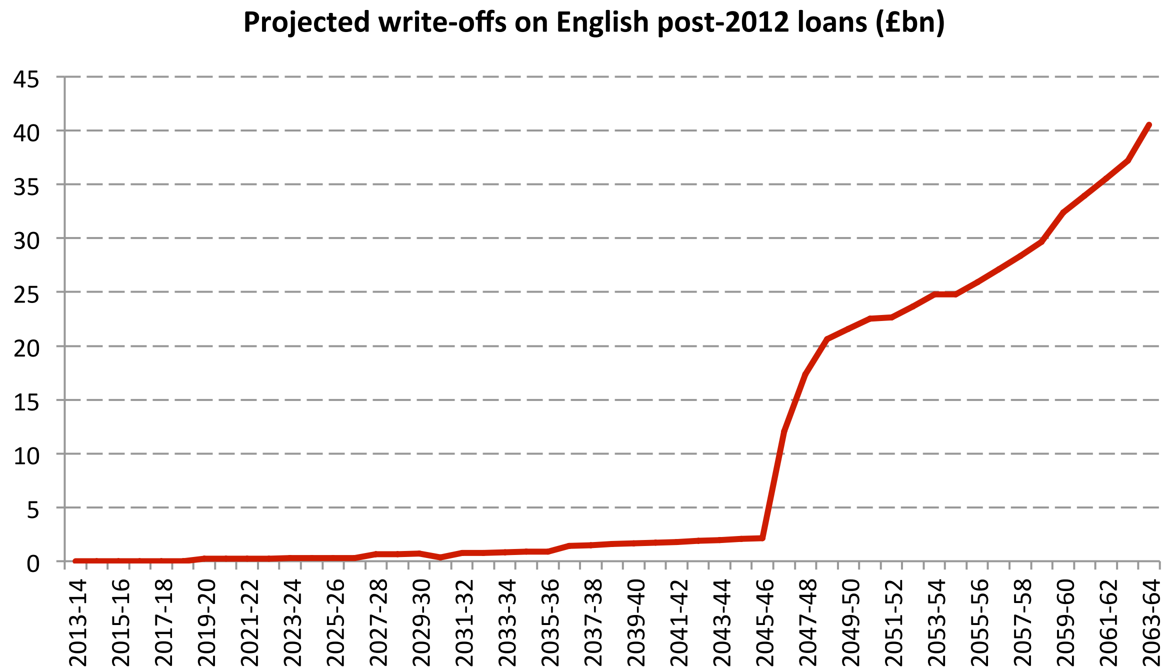
[11] Department for Business Innovation and Skills, *Impact Assessment: Higher Education: Students at the Heart of the System*, June 2011, p.32
[12] Department for Business Innovation and Skills, *Impact Assessment: Higher Education: Students at the Heart of the System*, June 2011, p.54
[13] Hansard, written answer, 12 January 2011, c379W
[14] Department for Business Innovation and Skills, *Impact Assessment: Higher Education: Students at the Heart of the System*, June 2011, p.54
[15] Hansard, written answer, 4 July 2013, c775W
[16] Hansard, written answer, 19 December 2013, c780W
[17] Hansard, written answer, 20 March 2014, c706W
[18] Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2014, Table B,1, p.170
[19] The OBR updated average wages figures in its latest Economic and Fiscal Outlook in December 2014. The Government has not published a recent updated revised RAB charge based on these figures. The House of Commons Library has used the recent OBR figures to calculate this and it is the latest available estimate of the RAB charge.
[20] London Economics, *The Higher Education fees and funding reforms in England What is the value of the RAB charge on student loans for the Treasury to break-even?*, March 2014

A higher RAB charge – driven by lower than expected average earnings – matters for the public finances because write-offs affect net borrowing as they are crystallised. In fact, figures from the Office for Budget Responsibility show that write-offs from the post-2012 student loans system are set to jump to £21 billion a year by 2048-49.

	Projected write-offs on English post-2012 loans (% GDP)	**Projected write-offs on English post-2012 loans (£bn)**
2044-45	0.03	2
2045-46	0.03	2
2046-47	0.16	12
2047-48	0.22	17
2048-49	0.25	21

Sources: OBR, Fiscal Sustainability Report, July 2014, Chart B.5; House of Commons Library analysis

The large increase from 2046-47 onwards coincides with the first cohort of graduates under the new system reaching the point at which their outstanding loans are written off.

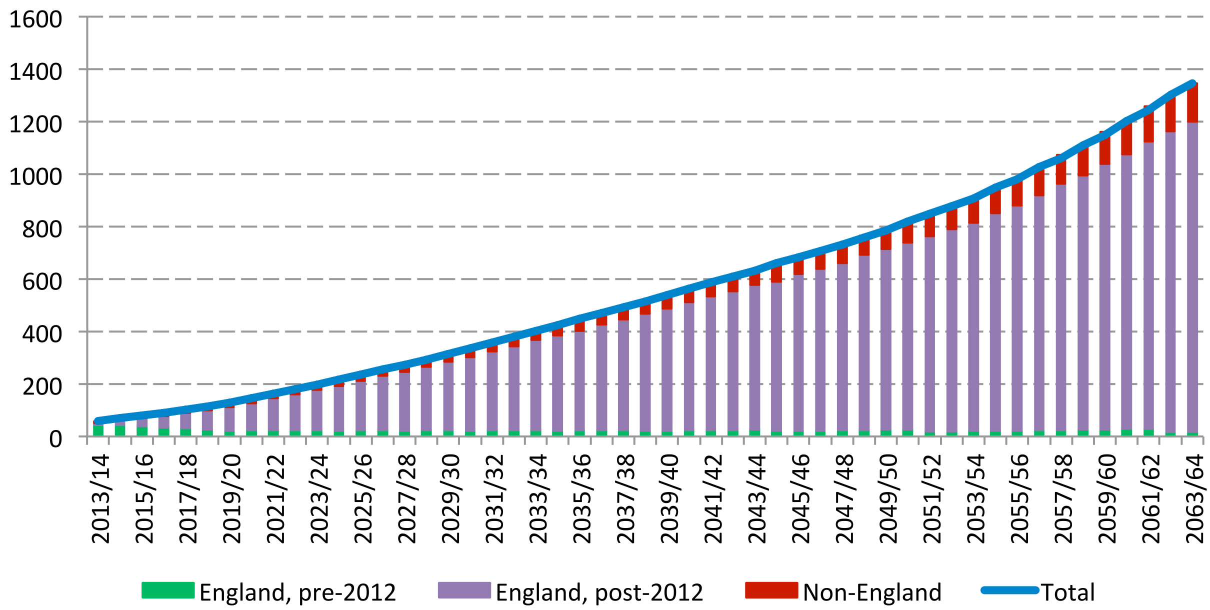


Source: Office for Budget Responsibility, Fiscal Sustainability Report, July 2014, Chart B.5

In addition, the way in which these loans are accounted for mean that they are effectively hidden in the public accounts. Even though we know these write-offs are going to happen, and the Government is not going to get this money back, the figures are not included in the current borrowing figures and will only affect net borrowing in 30 years' time.

The Government's broken system is also adding significantly to public sector net debt. Forecasts show that in 15 years' time, by 2030-31, the contribution of the post-2012 student fee system is set to add £281 billion to the national debt.

Addition to net debt from student loans (£bn)



Source: Office for Budget Responsibility, Fiscal Sustainability Report, July 2014, Chart B.1; House of Commons Library calculations

PRIORITIES FOR THE NEXT LABOUR GOVERNMENT

Labour believes that a successful higher education system should have five basic virtues:

1. It should allow our science base to grow ever more excellent, more globally competitive and more connected

2. It should offer potential students a genuine diversity of choice over how they progress to higher level skills, including those wishing to progress along the vocational track

3. It should remedy the deficiencies in our skills base

4. It should promote social mobility

5. It should be sustainable and underpinned by a public finance system that is affordable without loading young people with unsustainable levels of personal debt

Labour recognises that access to higher education is not just about getting our young people into the most elite universities. It is also essential that we have a system that is adaptable and meets the needs of a variety of learners, such as mature students, those with dependents and students who have other responsibilities. It must also be a system that caters for those who wish to progress along the vocational – not just the academic – track and allow people to study whilst they work and access essential courses closer to home. And it must be a system that raises aspiration amongst young people.

The next Labour Government is set to inherit a deficit of more than £75 billion. Even when the public finances are tight ensuring our universities are properly funded is an important priority for the next Labour Government. As part of that, all universities will of course be identifying and delivering efficiency savings.

A key priority for the next Labour Government will be new earn-while-you-learn 'Technical Degrees'; degrees which students can study for, in a wide range of subjects, while they are in a job and drawing a wage. This will support universities to drive new collaborations with industry. Co-funded, co-designed and co-delivered by employers and universities, Technical Degrees will also give firms real influence over the curriculum to ensure they get the skills they need to succeed.

This document sets out the scale of the problem created by the Government's failed system. We must ensure that there is a sustainable funding system for universities and that the system both protects taxpayers and delivers fairness for students and graduates.

Our manifesto will set out Labour's approach to deal with these problems. And our Zero-Based Review, will continue its work in the early months of the next Parliament looking at the fiscal position of the current loans system, to determine the extent of the problems and the longer-term impact on the public finances. It will also look at wider issues with the current part-time student system including very large drops in numbers in recent years. That is why the ZBR will review this area more comprehensively as a priority.

The Government's decision to triple tuition fees is not just leaving graduates with £44,000 of debt – it is also storing up problems for the longer-term. The next Labour Government is determined to fix the system so it works for universities, students, graduates and for taxpayers as a whole.

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