Removing fiscal illusions: National Accounting & Student Loans

Andrew McGettigan
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@amcgettigan
Government Review of post-18 Education & Funding (February 2018)

Terms of Reference:

“The review will not make recommendations related to the terms of pre-2012 loans or to taxation, and its recommendations must be consistent with the Government's fiscal policies to reduce the deficit and have debt falling as a percentage of GDP.”
Threshold increase: Expensive but not deficit increasing

May’s decision to increase the repayment threshold on post-2012 loans to £25,000 was very, very expensive:

- Estimated long-run cost: £2 billion plus per cohort by IFS & London Economics.
- The official RAB charge has increased from around 30% to c. 45%:
  - £15bn of new loans issued but “impaired” by £6.6bn.
  - Budgetary impairment allocation is only c. £4bn

But it also lowered the value of existing loans by £5.35 billion (DfE Accounts for 2017/18).

Fair Value of post-2012 loan book at 31 March 2018: £34.7bn (£31.6bn in 2017)

But does not significantly worsen the deficit in short-term ...
ONS review into Income Contingent Loans

- ICR loans treated like commercial loans for national accounting purposes
  - Using existing regulations & guidance
- Huge presentational *benefits* to treating ICR loans in this way
  - Deficit benefits from “fiscal illusions” (IMF, OBR)
- Office for National Statistics is now reviewing that decision
- ICR loans fail key definition: "There is an unconditional debt to the creditor which has to be repaid at maturity."
  - Payments are *conditional* (contingent on income)
  - Balances are not paid off “at maturity” (they are instead written off – “policy write-offs”)
- New bespoke ICR guidance is needed & international agreement
- Expecting a decision on 17 December
  - Implementation by end of 2019
THE DEFICIT & “FISCAL ILLUSIONS”
Accrued Interest on Student Loans is capitalised (receivable) interest *not* repaid interest
And it counts as income!

Chart 4.5: Interest and dividend receipts: student loans versus other sources

OBR, *Economic & Fiscal Outlook* March 2018
Accounting Identities:  
for single cohort in cash terms

\[
\text{Interest receivable} = \text{Outstanding Balance} + \text{Repayments}
\]

(1) Loan Outlay + Interest Receivable = Outstanding Balance + Repayments  
(2) Loan Outlay = Outstanding Balance + Repayments - Interest Receivable  
(subtracting Interest Receivable from both sides)  
(3) Loan Outlay - Repayments = Outstanding Balance - Interest Receivable  
(subtracting Repayments from both sides)
Cash Loss (or Surplus) can be captured two ways

Placing repayments (white) over Loan Outlay & Interest receivable (white) over Outstanding Balance. Shows difference (shaded in blue) is equal.

Loss or Gain is difference between:
Loan Outlay and Repayments Or Outstanding Balance and Interest receivable

But huge timing & presentational benefits from using the latter
Fiscal impacts - % of GDP
loan scheme appears to generate surplus!

Supplementary Table 2.2: OBR, Fiscal Sustainability Report July 2018
Policy Write-offs: single cohort annually
Annual Accrued Interest: All Balances!
1. **Treat like graduate tax**
   Repayments as Income; Outlay as Expenditure

2. **“Recording Interest when Paid”**
   Most likely – though challenge to achieve “sectoral balances”
   Decision: loan repayments are made against principal *first*
   More generous policy may force change in accounting treatment

3. **“Hybrid Approach”**
   Recognise “upfront” the proportion of loan unlikely to be repaid (*expenditure today*)
   Preferred by OBR?
   *Involves using estimated figures and revising*
   *Interest cannot be charged against balances written off! Repayments reduced!*

4. **“RAB-style”**
   Estimated cost booked upfront
   ONS: “Not consistent with National Accounting principles”
   Danger of double-counting: cost of servicing debt
OBR, Economic & Fiscal Outlook (Oct 2018)

Chart A: PSNB under different treatments of student loans

- Currently-used loan treatment
- Revenue and expenditure
- Hybrid
- No student loans

Source: OBR
Impact of Option 2: “removing interest’s fiscal illusion” (OBR figures)

Interest recorded as income

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<td>Student loan interest</td>
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<td>6.1</td>
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Removing interest from “the deficit”:
Public Sector Net Borrowing (PSNB) targeted by fiscal mandate

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<td>% GDP</td>
<td>1.2%</td>
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<td>1.2%</td>
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removing interest fiscal illusion

| %GDP                  | 1.4%    | 1.7%    | 1.4%    | 1.3%    | 1.2%    | 1.1%    |

Nominal GDP (£ billion)$^{1,2}$

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Concluding Comments

• Delay to Augar panel reporting:
  – Can only be consistent with deficit reduction if we know what counts as deficit
  – Awaiting ONS review (17 December)

• Presentational Impact becomes Political
  – Costs recognised now as expenditure or illusory benefits removed from income
  – Affects “Fiscal Phil” Hammond’s Fiscal Rules significantly
  – Will “Fiscal Rules Rule OK?” if PSNB revised?
    • Resulting changes to HE budgets?

• More positively:
  – Loss of presentational advantages of loans
  – Makes other policies more feasible – they appear less costly in comparison
    • Even if only reducing interest rate taper!