Consultation Response:
Student Loans inquiry

To: Treasury Select Committee

By: The Intergenerational Foundation

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The Intergenerational Foundation (www.if.org.uk) is an independent think tank researching fairness between generations. IF believes policy should be fair to all – the old, the young and those to come.

Introduction

The Intergenerational Foundation (IF) welcomes the opportunity to contribute to the student loans inquiry. The student loan system has seen numerous changes in recent years, from the rise of tuition fees to the removal of maintenance grants. IF is pleased to see that this system is being scrutinised, and wishes to submit a response which addresses the following points from this inquiry's terms of reference:

"What are the implications of student loan repayments throughout an individual's career on:
- The ability to get on the property ladder;
- the ability to save for retirement; and
- the incentives to find work."

The 9% repayment rate results in a significant marginal tax for graduates. Student loan repayments, added to Income Tax (minimum 20%) and National Insurance (12%), mean young earners reaching the repayment threshold are facing a marginal tax rate of at least 41%[1] - one of the highest marginal tax rates in the world. Such a high rate is concerning for a number of reasons, not least because it reduces the opportunities for new graduates to save towards traditional milestones such as buying property and saving to support a family.

The government have repeatedly justified the 9% repayment rate on the basis that graduates supposedly enter higher salaried jobs. This justification has been discussed in terms of a 'graduate premium': the idea that graduates earn more across their lifetimes as a result of having completed a degree. However, fewer graduates than ever are actually working in graduate jobs, and instead leave University to find themselves in a low-paid, low-skilled role. The ONS estimates that even amongst non-

[1] http://www.if.org.uk/campaign/parents-against-student-debt/

recent graduates (those who left higher education at least 5 years ago), 35.5% across the UK are working in non-graduate roles.[2]

The 9% comes straight out of young earners' disposable income. Not only does this have a tangible effect on the daily life of a young person trying to balance multiple other socioeconomic pressures, it is a significant amount which is not put back into the real economy. This is a particularly heavy economic burden, which previous generations have not had to pay.

The 2015 decision to freeze the repayment threshold, going back on promises to increase it in line with inflation, seriously undermined trust in the student loan system. A commercial lender would be unable to change the terms of its loan in such a way. These changes highlight how vulnerable graduates and young earners are to the volatile terms of their student loan. Even though the recent decision to raise the repayment threshold to £25,000 is very welcome, it is yet another example of the constantly changing terms which graduates must tolerate.

"*Is RPI the right measure? What would the impact be of the Government applying an alternative reference rate to student loans?"*

IF calls for a change from RPI, as the measure of inflation applied to student debt, to CPI. RPI is a rate that has been labelled as "flawed", and having "serious shortcomings" by the ONS,[3] and it seems wholly unfair that it should be applied to a debt facing so many young people. RPI is no longer the predominant measure of inflation, having been replaced by CPI in 2003, so it seems perverse that it is still being used for such an important purpose. Recently, Mark Carney called for the withdrawal of RPI because of the known errors involved in its calculations.[4]

Nicky Morgan has recently suggested [5] that with the government setting such astronomical tuition fees (which rank among the highest in Europe, and far higher than Scotland, Northern Ireland and Wales[6]), it seems reasonable to apply a slightly kinder interest rate. Recently, even Lord Willetts (the architect of the current student loan system) stated that student loan interest rates should be reduced.[7] Current students in England are already graduating with an average debt three times greater than their European counterparts, and are still charged an extortionately high interest rate, despite living in an era of ultra-low bank rates. The injustice of this is made stark when compared to the interest rates applied to graduates with a Plan 1 loan, who are charged APR interest at just 1.5%. For many recent graduates, it seems they are being punished for being born just a few years too late.

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2 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/adhocs/005742percentageofgraduatesworkinginnongraduaterolesinlondonandtheuk2011to2015

3 https://www.ft.com/content/b60fb1ae-1cda-397f-9968-af131943c5bd

4 https://www.ft.com/content/df9780d8-05e5-11e8-9650-9c0ad2d7c5b5

5 https://inews.co.uk/news/education/tories-revolt-soaring-interest-rate-student-loans/

6 https://www.timeshighereducation.com/student/news/10-cheapest-universities-europe

7 http://www.bbc.co.uk/news/education-43031541

"On what basis was RPI + 3% established? Is this fair, given the current Bank of England base rate (0.25% at the time of writing)?"

IF also wishes to draw attention to the additional interest added to student loans – the RPI +3% while studying, and the sliding scale of RPI +3% upon graduation. RPI +3% brings the interest rate on student debt to 6.1%. As Dr Bradshaw (the Russell Group's acting director) writes, these levels are "out of touch" with other commercial lending rates.[8] Consequently, student debt is increasing to levels which are almost impossible to repay in a working lifetime.

A 2014 London Economics report estimated that 60% of students will have at least part of their student debts written off.[9] This is a shockingly high number, and highlights the very real impact of high interest rates. Even when graduates do manage to repay their loan, they end up repaying a substantial amount more than they borrowed, thanks to these huge interest rates. For example, a graduate with a debt upon graduating of £52,350 and on a £25,000 starting salary, will end up repaying £81,000.

Much discussion focuses on the sliding scale of interest applied after graduation. However, many forget that RPI +3% is applied to all students while they are studying, rather than the interest rate being means-tested, as it is once they've graduated. If this was reduced to RPI +0% while studying then the average student would graduate with £3,000 less debt.[10]

Conclusion

IF is delighted to see that this inquiry has been established to investigate the terms of the student loan system, and urges clear action and tangible change, to make the terms of student loans fairer for young people. The potential reforms outlined above would make a significant difference to young graduates, and create a society which values Higher Education, regardless of the high price tag attached to it.

If you would like to learn more about the work of the Intergenerational Foundation please contact:

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[8] https://www.theguardian.com/money/2017/jul/18/russell-group-urges-rethink-student-loan-interest-rate
[9] http://londoneconomics.co.uk/blog/publication/higher-education-fees-funding-reforms-england-breakeven-rab-charge-treasury/
[10] https://www.ifs.org.uk/publications/10154