

Income-Contingent Student Loans: Repayment Threshold

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From: [REDACTED]

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Repayment Threshold

- The declared policy intention is to increase the income threshold for Income Contingent Repayment loans from 2010-11 onwards using RPI as the index. This decreases the cost to the graduate and increases the cost to Government; but also helps maintain the argument that the repayment regime is benign.
- Uprating by RPI is recommended in the short term. But if RPI is negative, we recommend holding at £15k rather than reducing the threshold (and in parallel charging no interest, rather than negative interest)
- In longer run, uprating by earnings growth may need to be considered, but not now, and certainly not until after the tuition fees review
- There are practical as well as policy considerations. If the threshold is to be changed, HMRC need to know by the beginning of April 2009 to ensure the appropriate arrangements are in place to make accurate and timely collection of student loans from April 2010.

Devolved Administrations

- [REDACTED]

Background

- During the passage of the Higher Education Bill in 2004, it was announced that the income threshold for repayment would be increased to £15k from 2006 (from £10k), and remain at that level until April 2010 when it would be reviewed.
- Budget calculations have been made on the basis that the threshold would be uprated by the RPI and apply from FY 2010-11, and annually thereafter. For 2010-11 the forecast was an RPI rate of 2.8%.
- It was always expected that the RPI would be positive, but it seems likely that it will be negative, thereby complicating the policy question

Options - Increase in repayment threshold

- **Change (decrease) the threshold in line with RPI:** Ministers' declared policy intention is to use RPI to set the income threshold for ICR loans from 2010-11 onwards. Exceptionally this year, to follow RPI would be likely to *decrease* the repayment threshold
- **Retain the £15k threshold:** As the RPI rate is likely to be negative very shortly, there is an option to retain the £15,000 threshold and take the decision to uprate by RPI from 2011-12. This **recommended** option is reflected in the parallel submission regarding interest rates.
- **Change (increase) the threshold in line with earnings growth:** Because wages rise at a faster rate than prices, uprating by RPI means that the threshold would over time decline relative to average earnings and graduate starting salaries. Uprating the threshold by earnings growth would be a sustainable policy in the long term, but it would be expensive.

Change the threshold in line with RPI

- It is likely that RPI will be negative in March 2009, so using the RPI will lead to the *reduction* of the threshold from April 2010
- To reduce the threshold in the current economic downturn may give us difficult presentation issues
- We do not recommend this option for 2010-11.
- In future years, though, we think uprating the threshold by RPI strikes the right balance between affordability and treating graduates fairly, even though if the threshold is consistently uprated by RPI (even when positive), the proportion of borrowers with incomes over the threshold increases over time because wages tend to increase faster than prices. Thus the threshold could gradually be seen as too low and uprating by prices may not be politically sustainable in the long term.

Retain the £15k threshold in 2010, uprate by RPI from 2011

- Due to the negative RPI rate, we **recommend** that Ministers hold the threshold at £15,000 for a further 12 months.
- For presentational purposes this is consistent with the recommendation in the parallel submission that the interest rate should be 0%, rather than reducing both the threshold and the interest rate by negative RPI.
- From 2011-12, we recommend that the threshold is uprated by RPI
- We have already allowed for this in our forecasts
- We recommend that the Minister announces his intention to review the threshold from 2011-12, and that this is expected to be in line with RPI.

Change the threshold in line with earnings growth

- The advantage is that the repayment threshold keeps up with increases in earnings, and broadly the same proportion of graduates are due to repay once they start work
- The drawback is that to update the threshold by earnings growth from 2010-11, would incur immediate cash consequences estimated at £30m in the current CSR period, there would be non-cash costs of £1.4bn over the CSR period reflecting a longer term cash pressure.
- This option is too expensive, and therefore not recommended.

Next Steps

- If Minister is content with our recommendation to freeze the threshold at £15k for a further year, and agree to review the threshold in 2011 in line with RPI, then we will approach the DAs and Treasury with our proposals.
- Once we have agreement we will notify the Minister, and with his agreement advise HMRC.