



Office for
**Budget
Responsibility**

Fiscal sustainability report 2018 and accounting for student loans

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Chairman

17 July 2018

Material published today

- OBR
 - Fiscal sustainability report 2018
 - Student loans and fiscal illusions
- HM Treasury
 - Managing fiscal risks
- ONS
 - Looking ahead: developments in public sector finances statistics

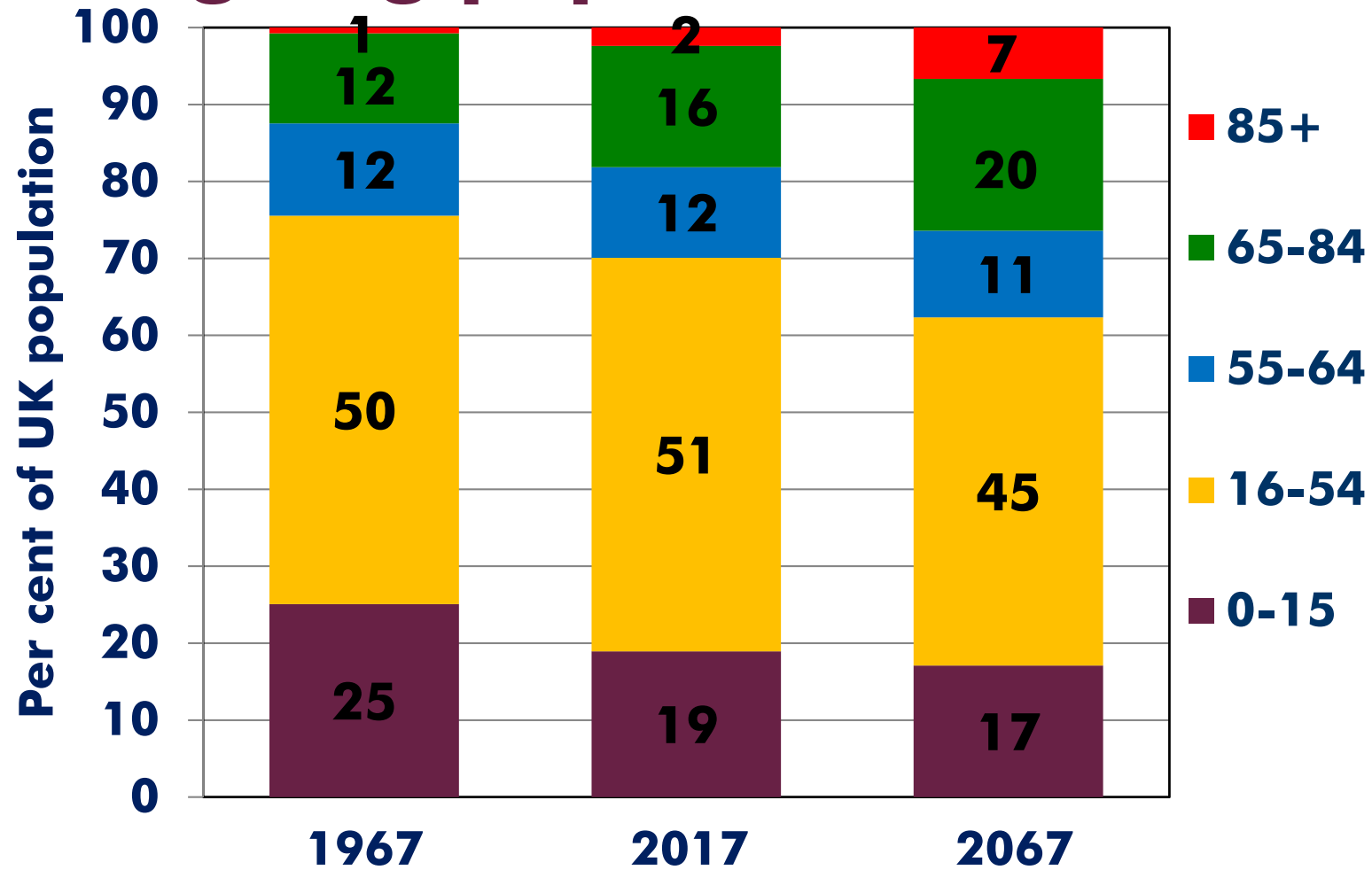
Focus of my remarks

- Long-term public finance projections
 - Chapters 3 and 4 of the FSR
- Accounting for student loans
 - Working paper

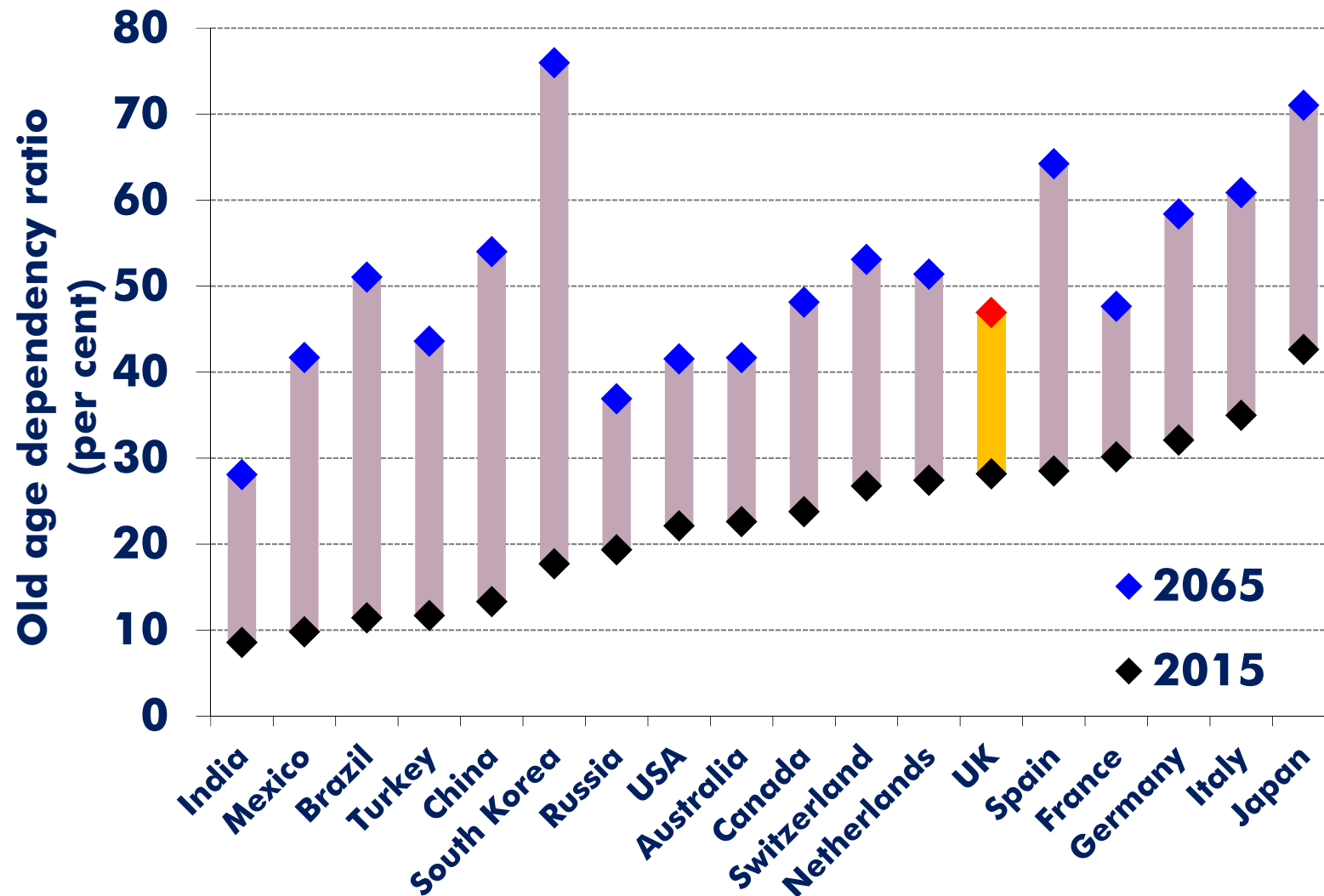
Long-term projections

- Cover spending, revenue, balance and debt
- 50-year horizon
- Based on current policy, as best defined
- Projections, not precise forecasts
- Sensitivities important

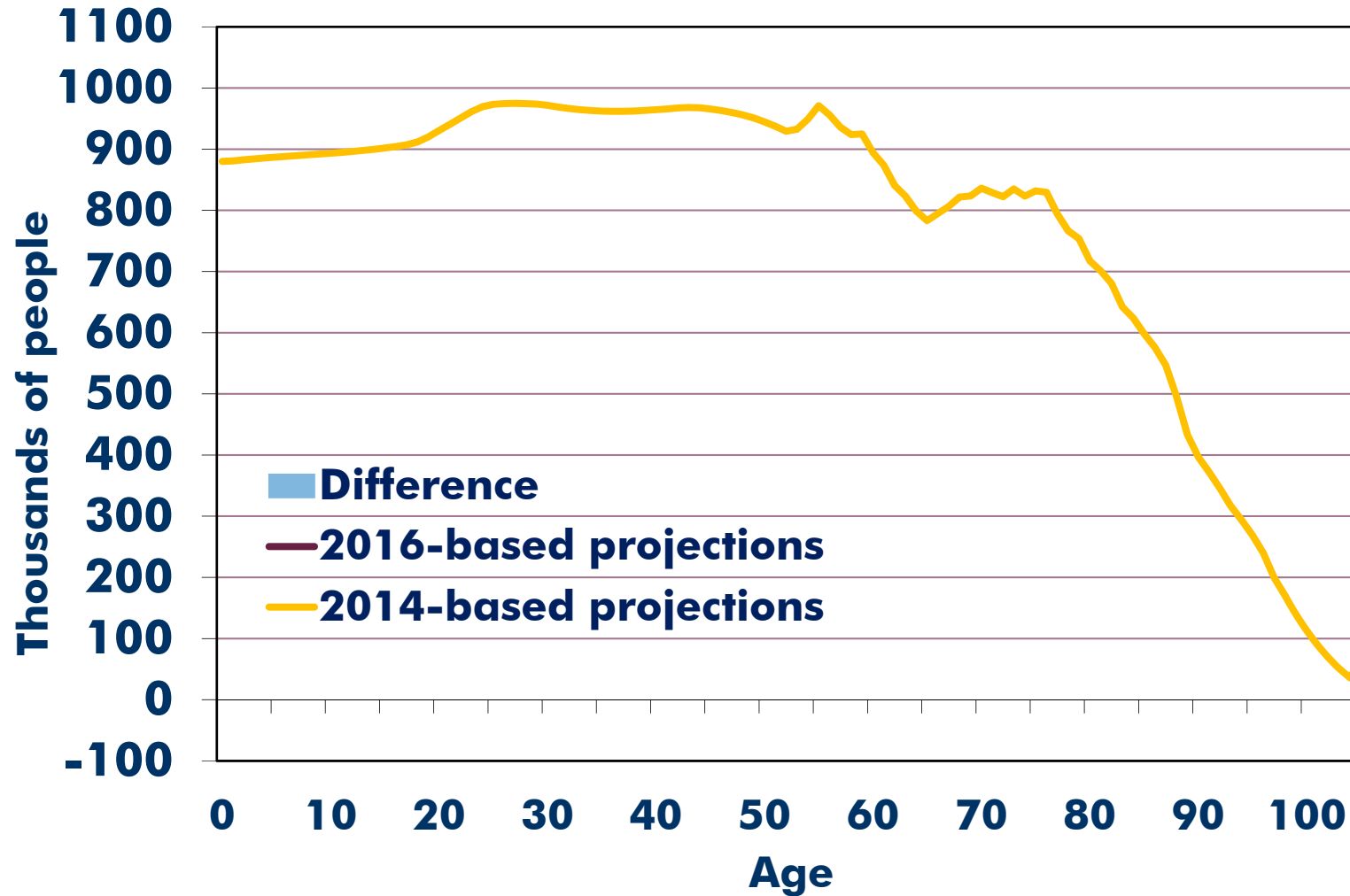
The ageing population



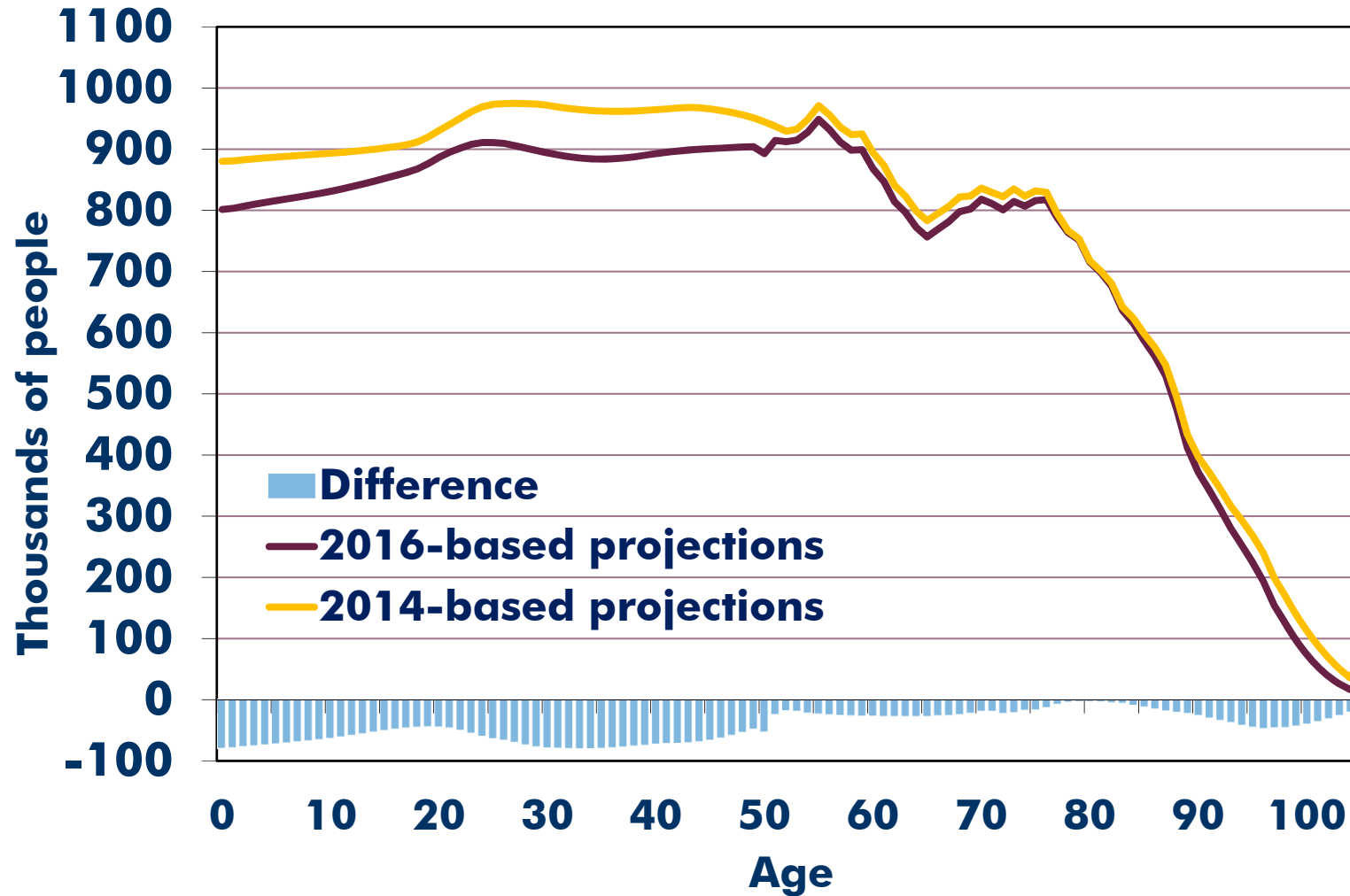
Old-age dependency ratio



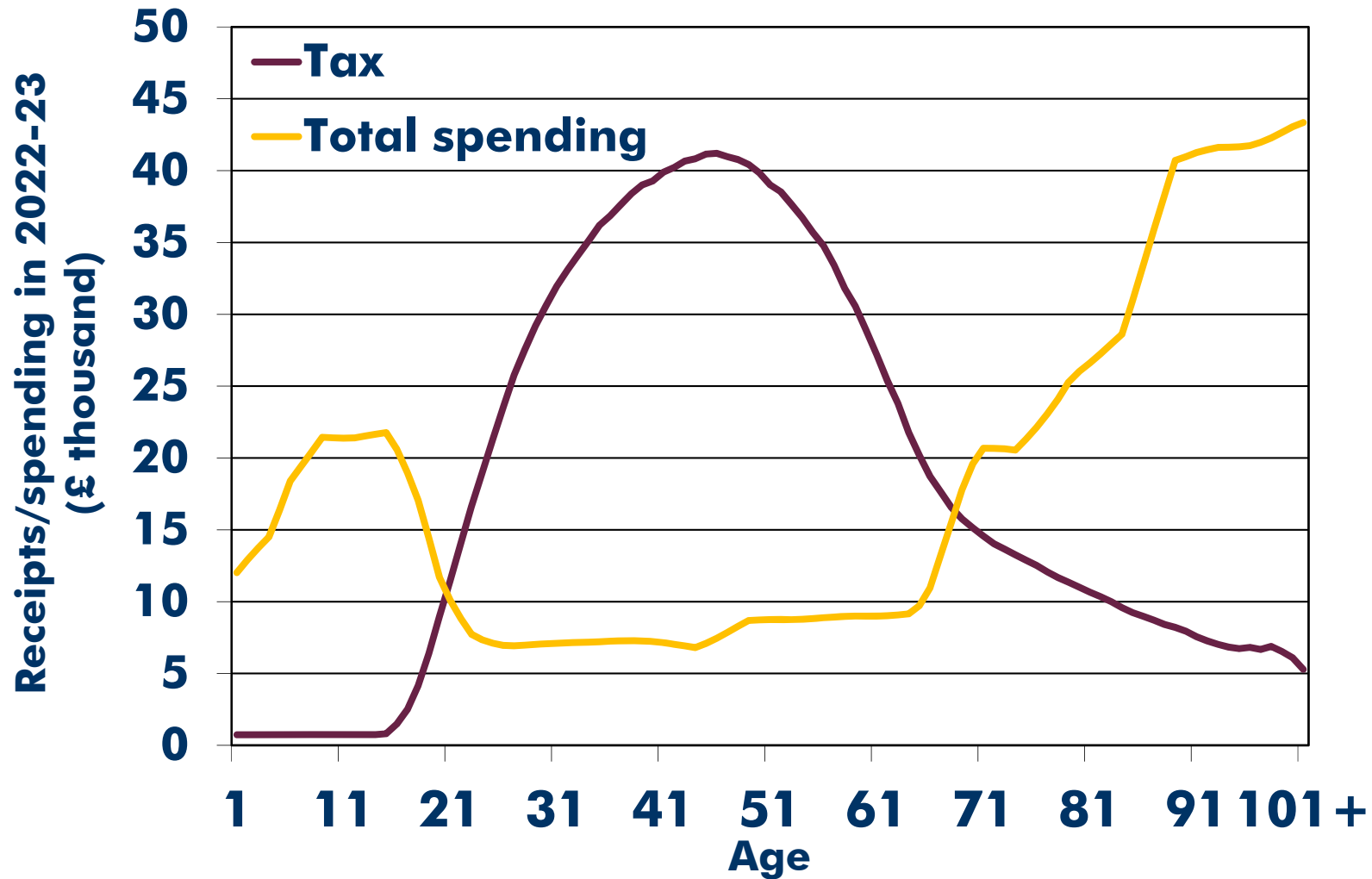
Population by age



Population by age



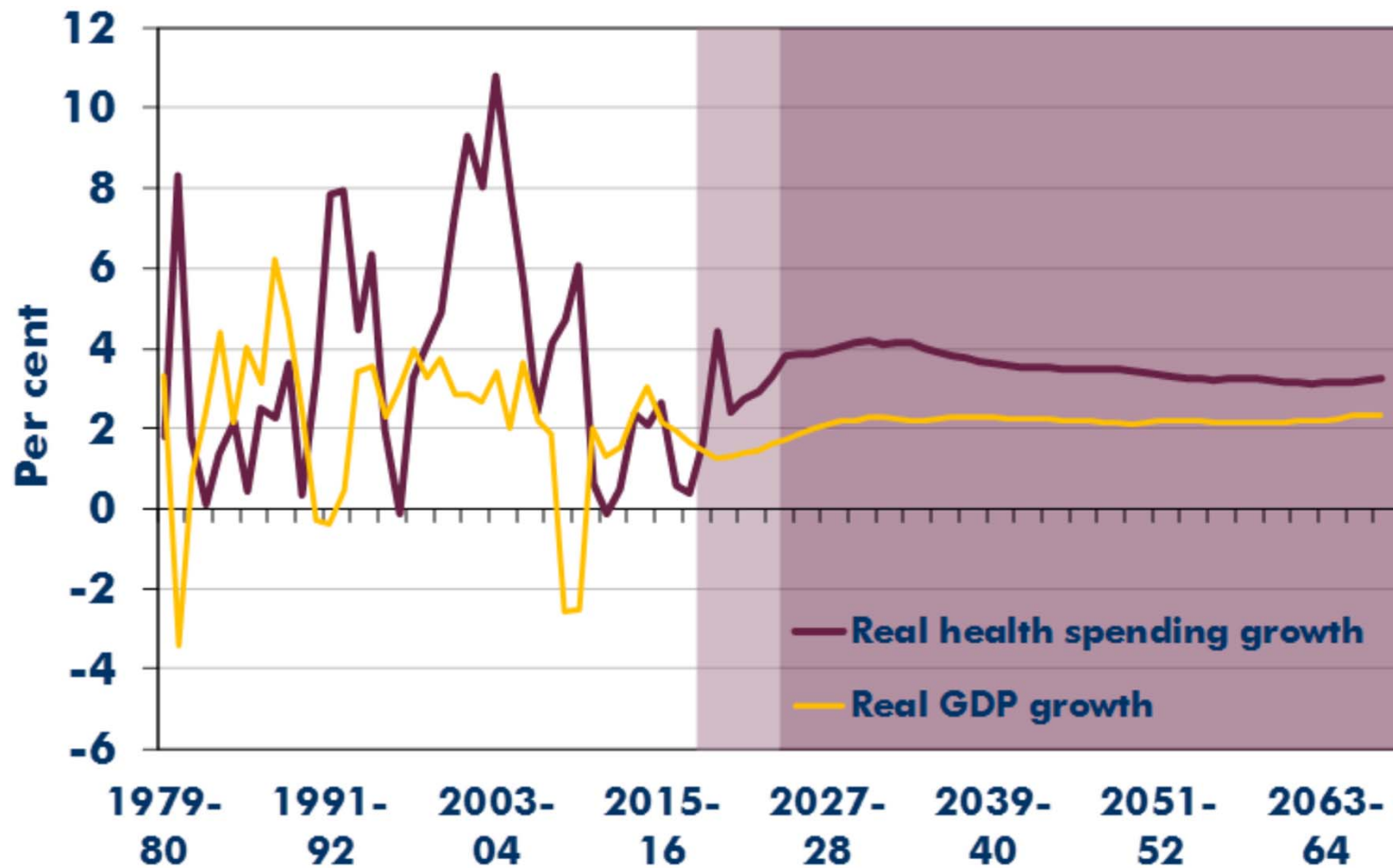
Revenues and spending by age



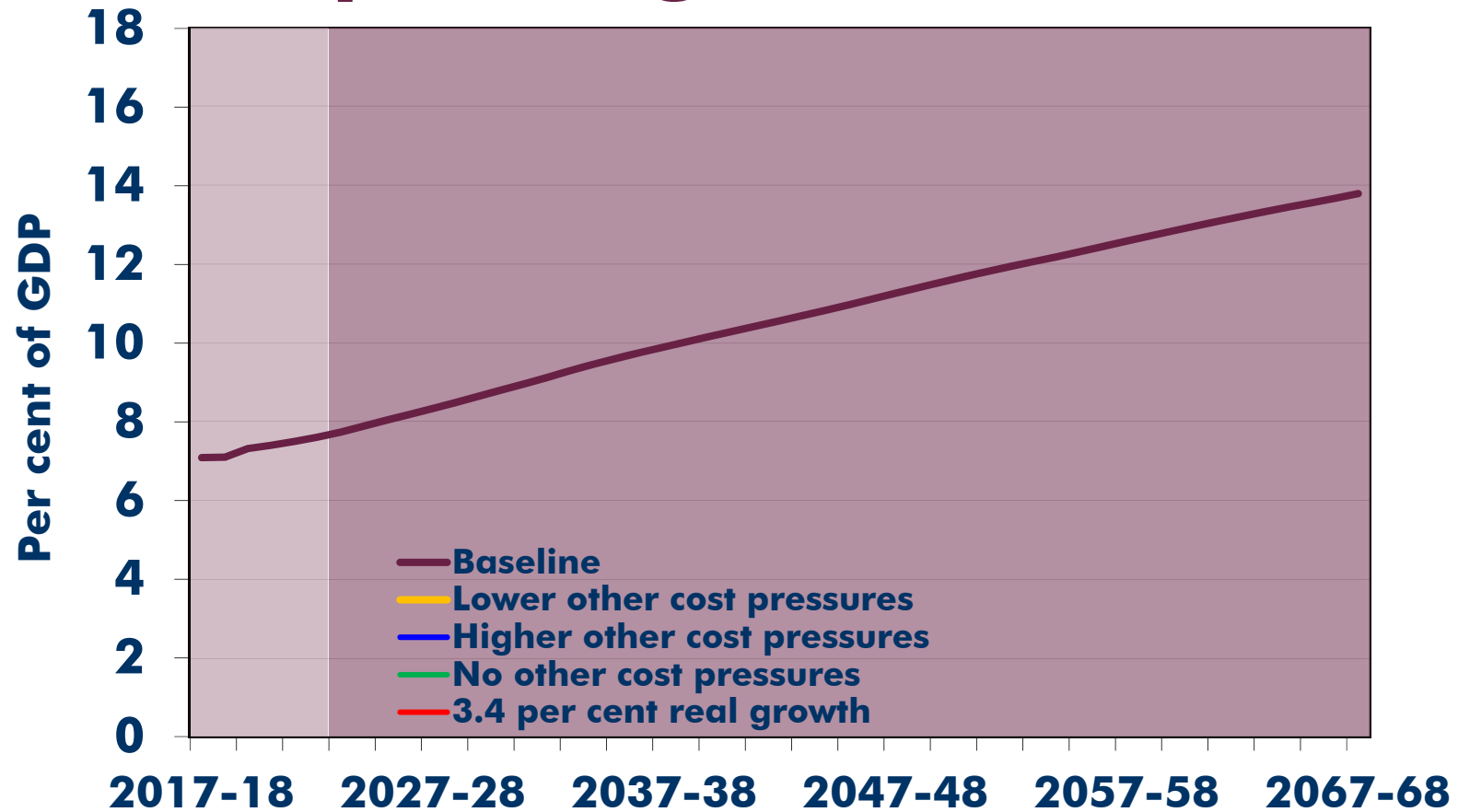
Other cost pressures in health

- Spending assumed to accommodate non-demographic pressures on health
- Technological advances
- Relatively weak productivity growth
- Spread of chronic conditions

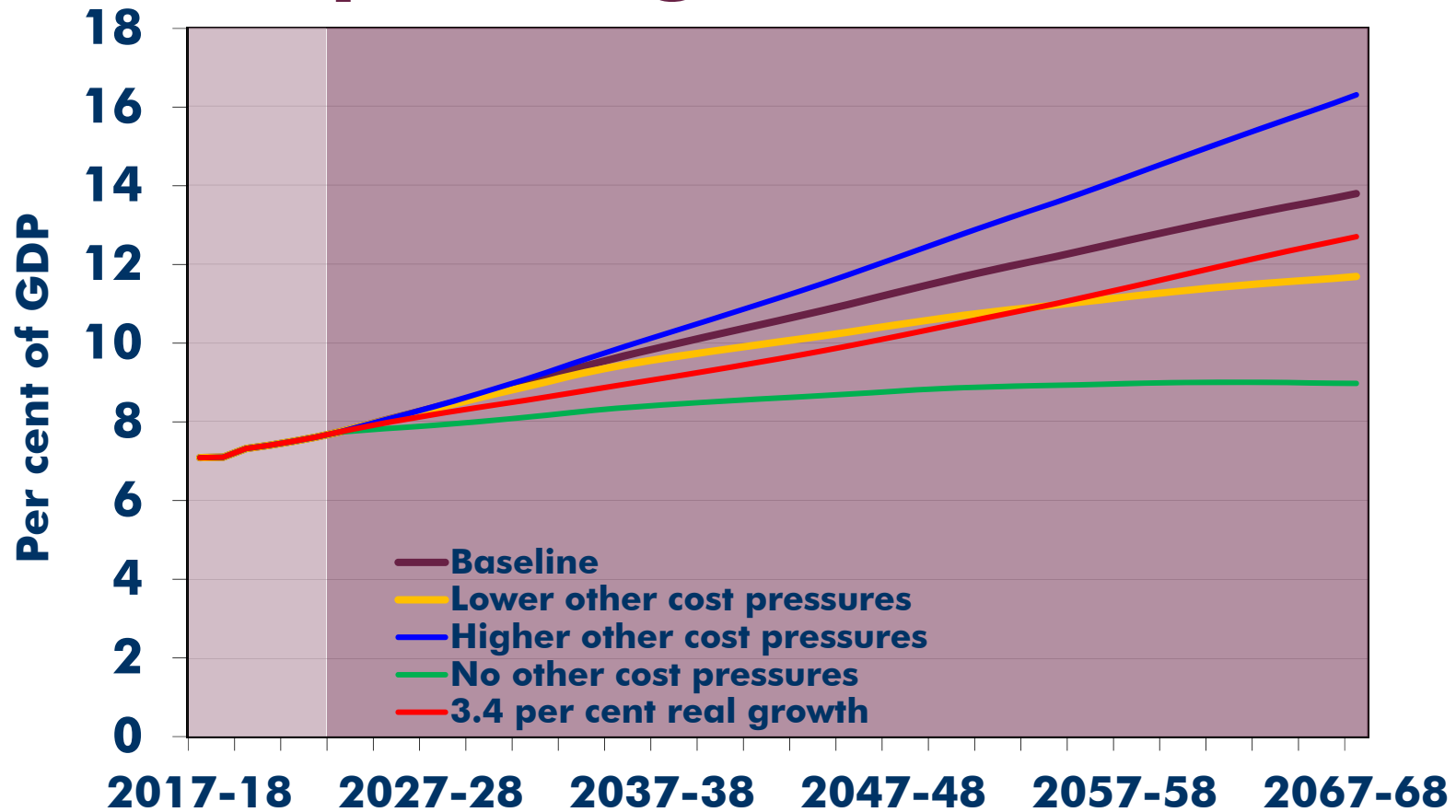
Real growth in health spending



Health spending as % of GDP



Health spending as % of GDP



Non-interest spending

Per cent of GDP	2017-18	2022-23	2067-68
Health	7.1	7.6	13.8
Adult social care	1.2	1.3	1.9
Education	4.3	4.1	3.8
State pensions	5.1	5.0	6.9
Pensioner benefits	0.8	0.8	1.3
Public service pensions	2.0	2.1	1.5
Total age-related spending	20.5	20.9	29.2
Other welfare benefits	4.8	4.5	4.2
Other spending	11.4	11.0	11.2
Spending	36.7	36.4	44.6

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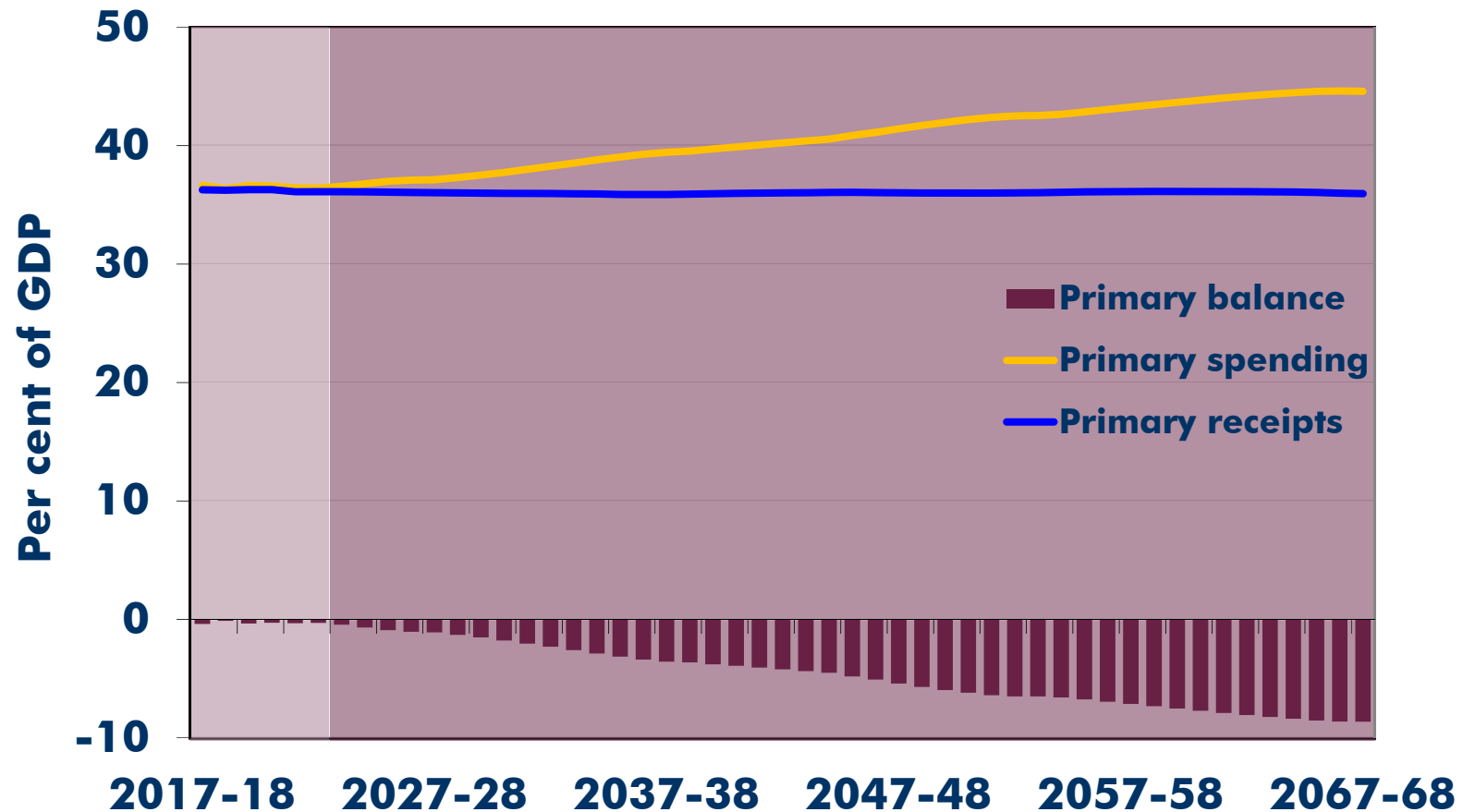
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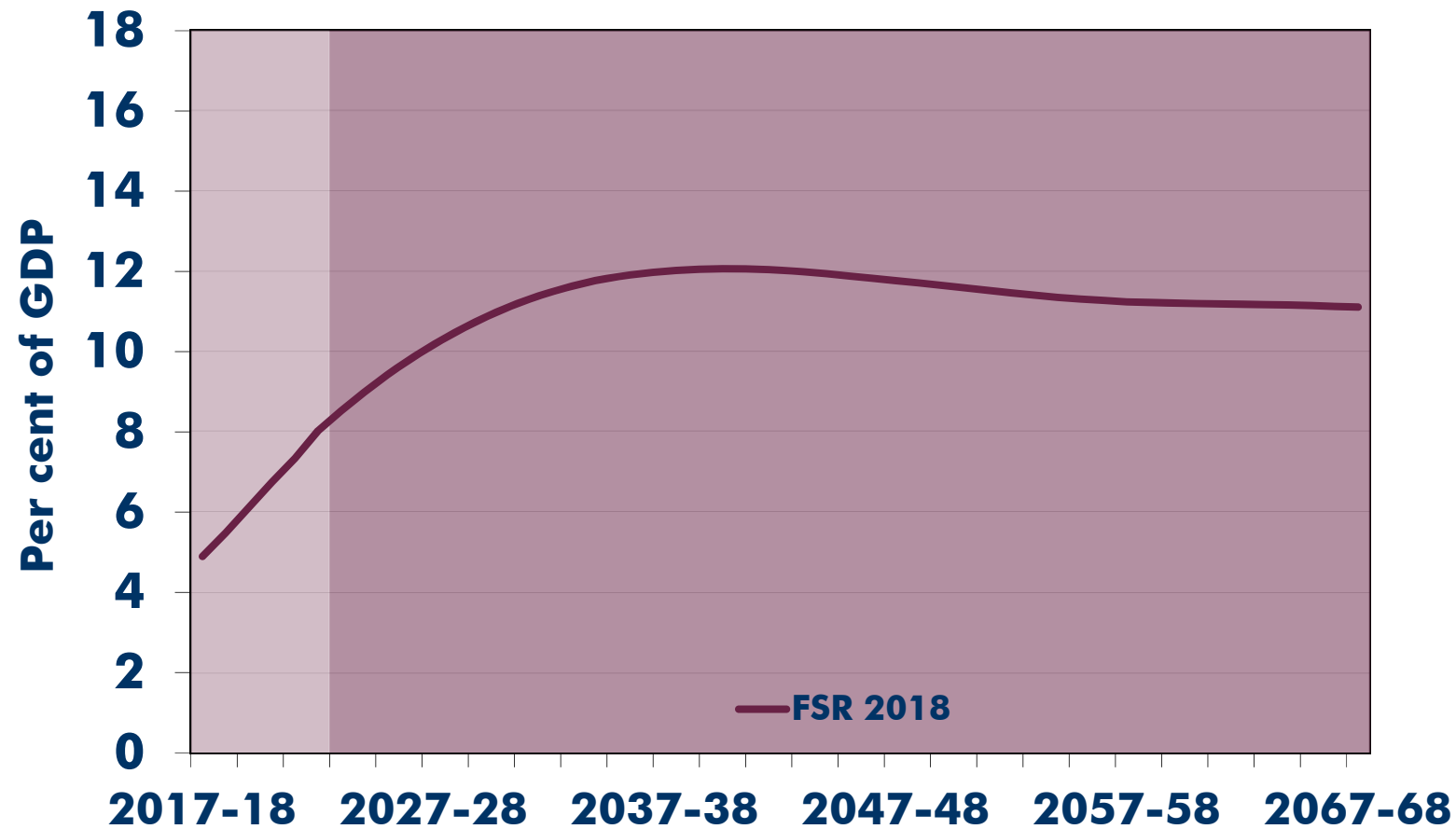
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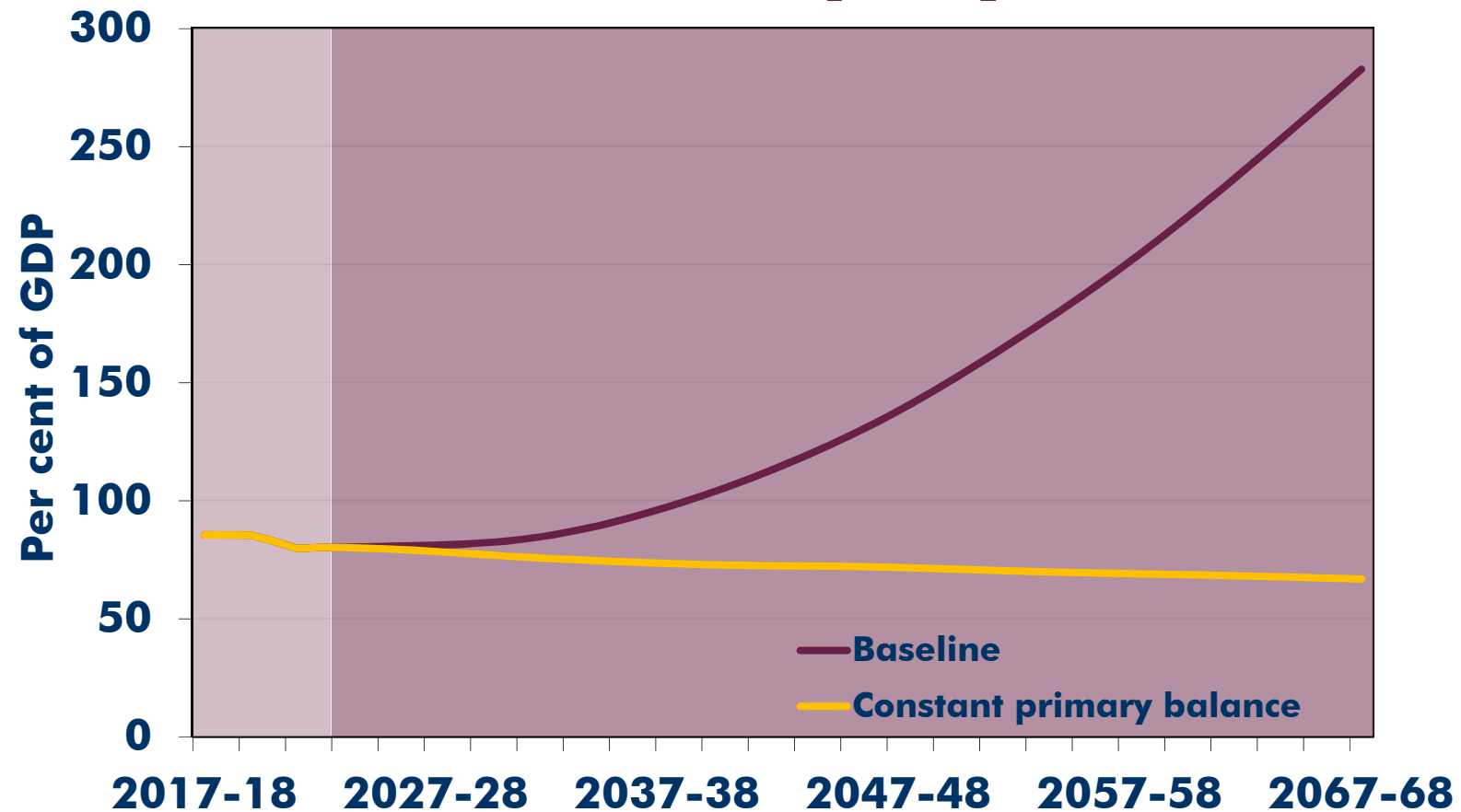
The primary budget balance



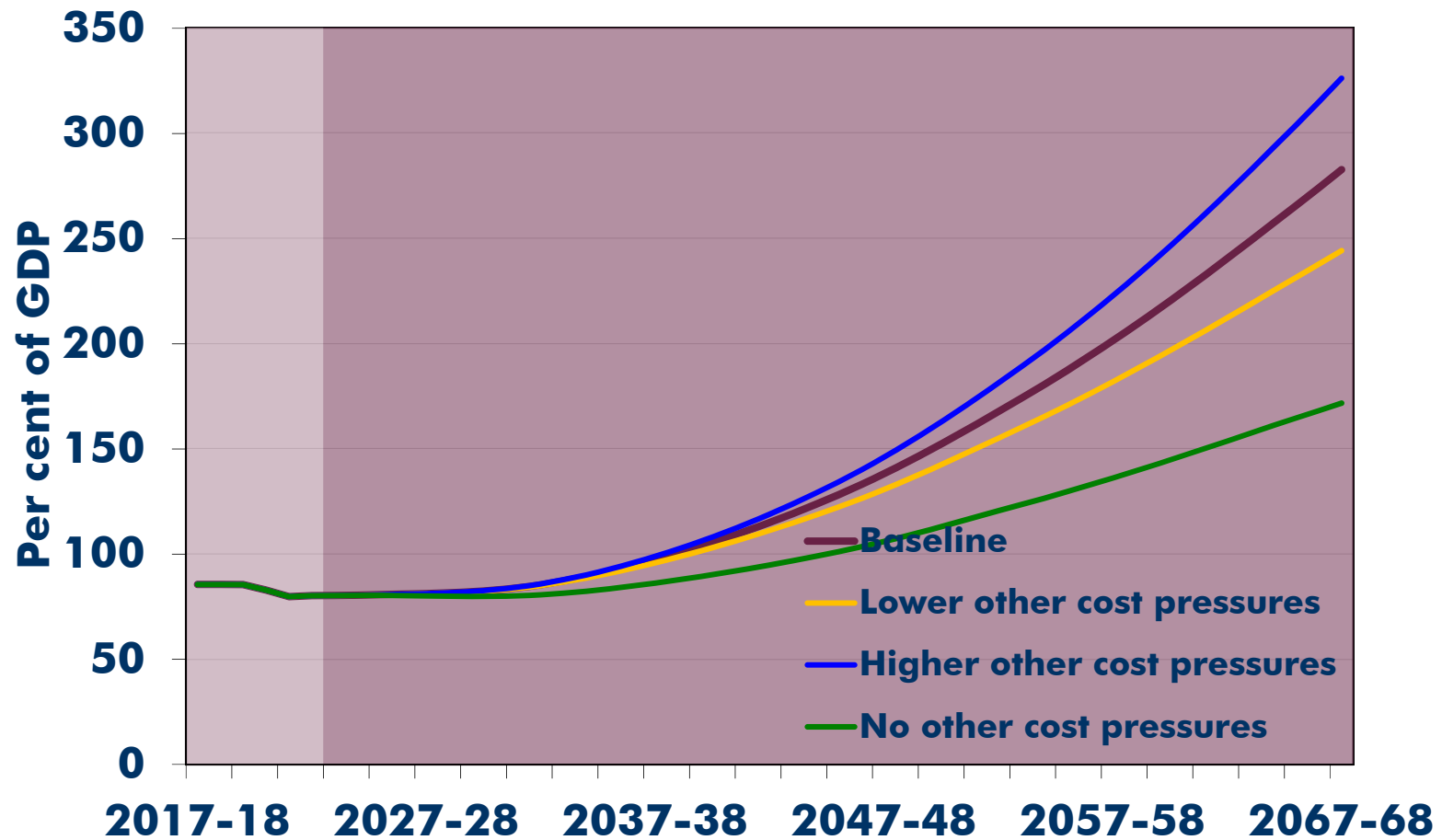
Student loans and net debt



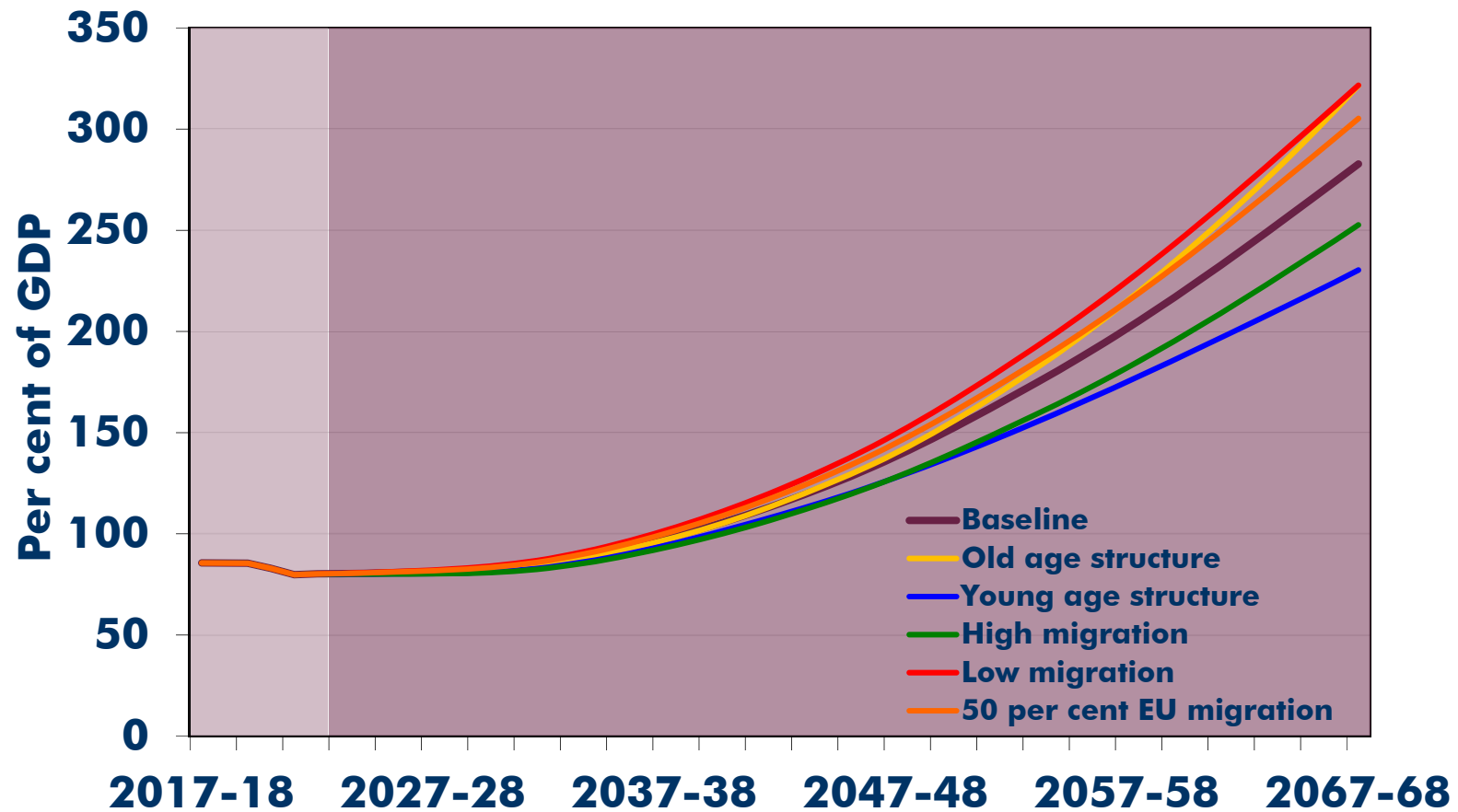
Net debt: baseline projection



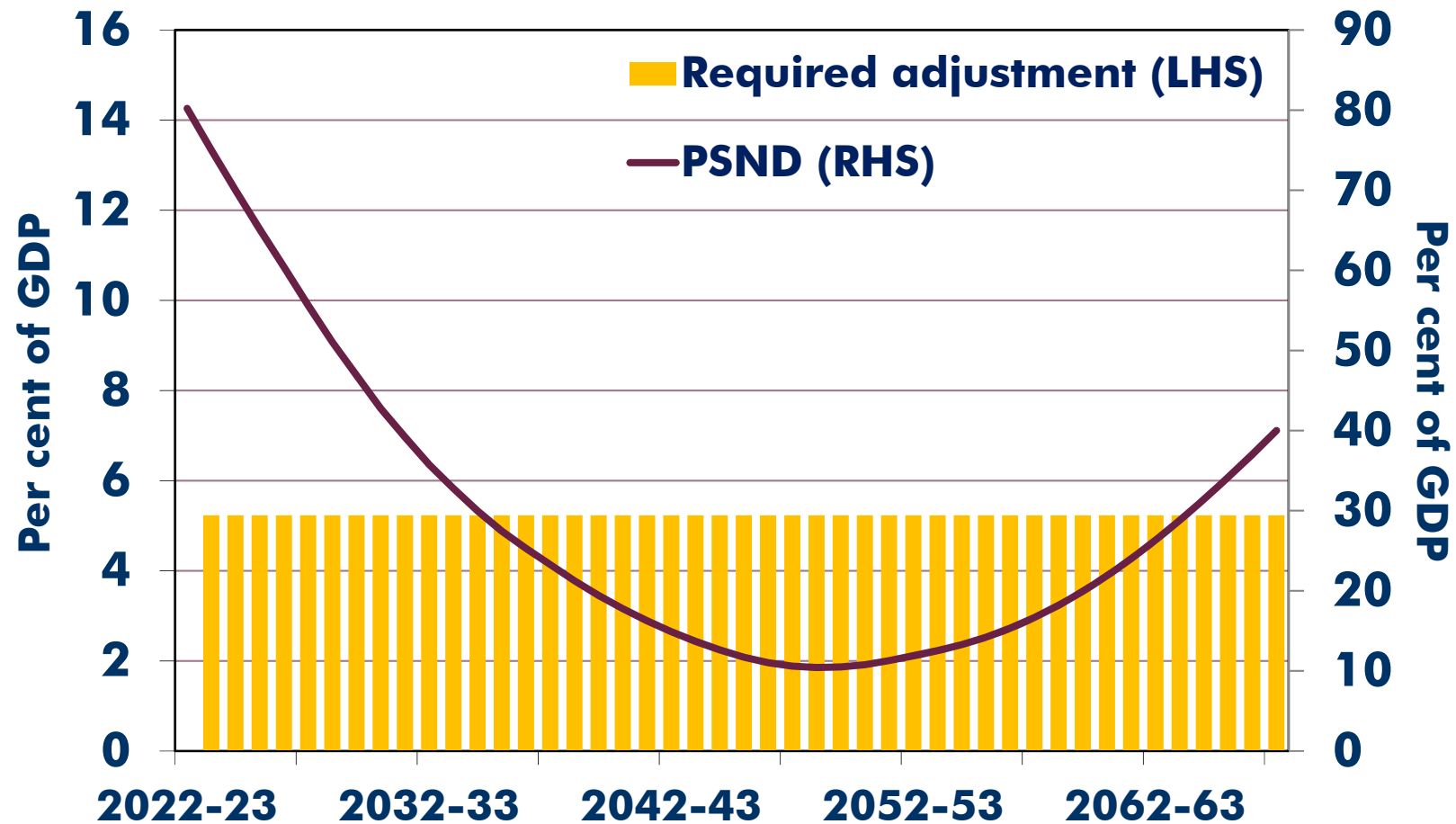
Net debt: sensitivities



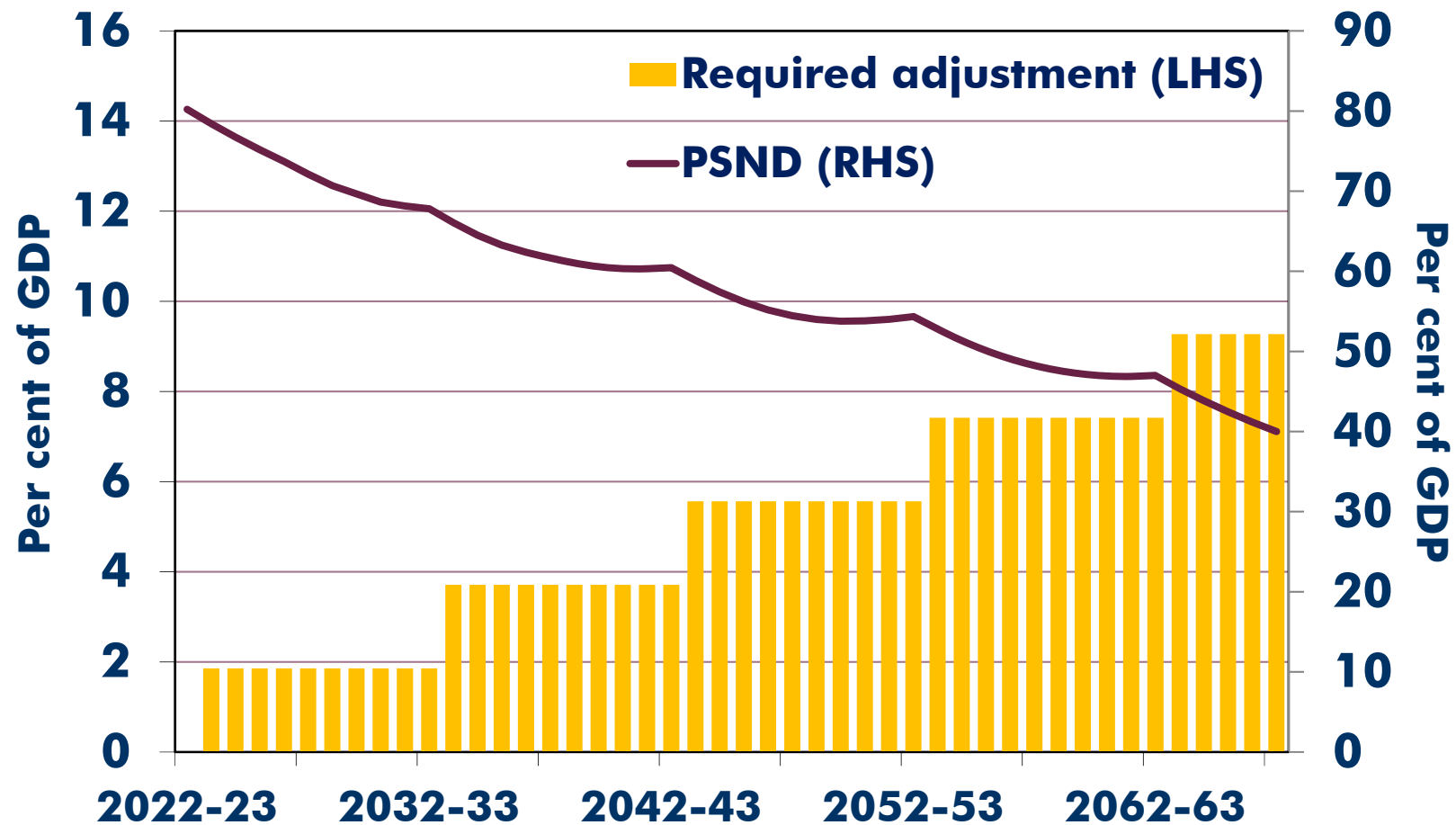
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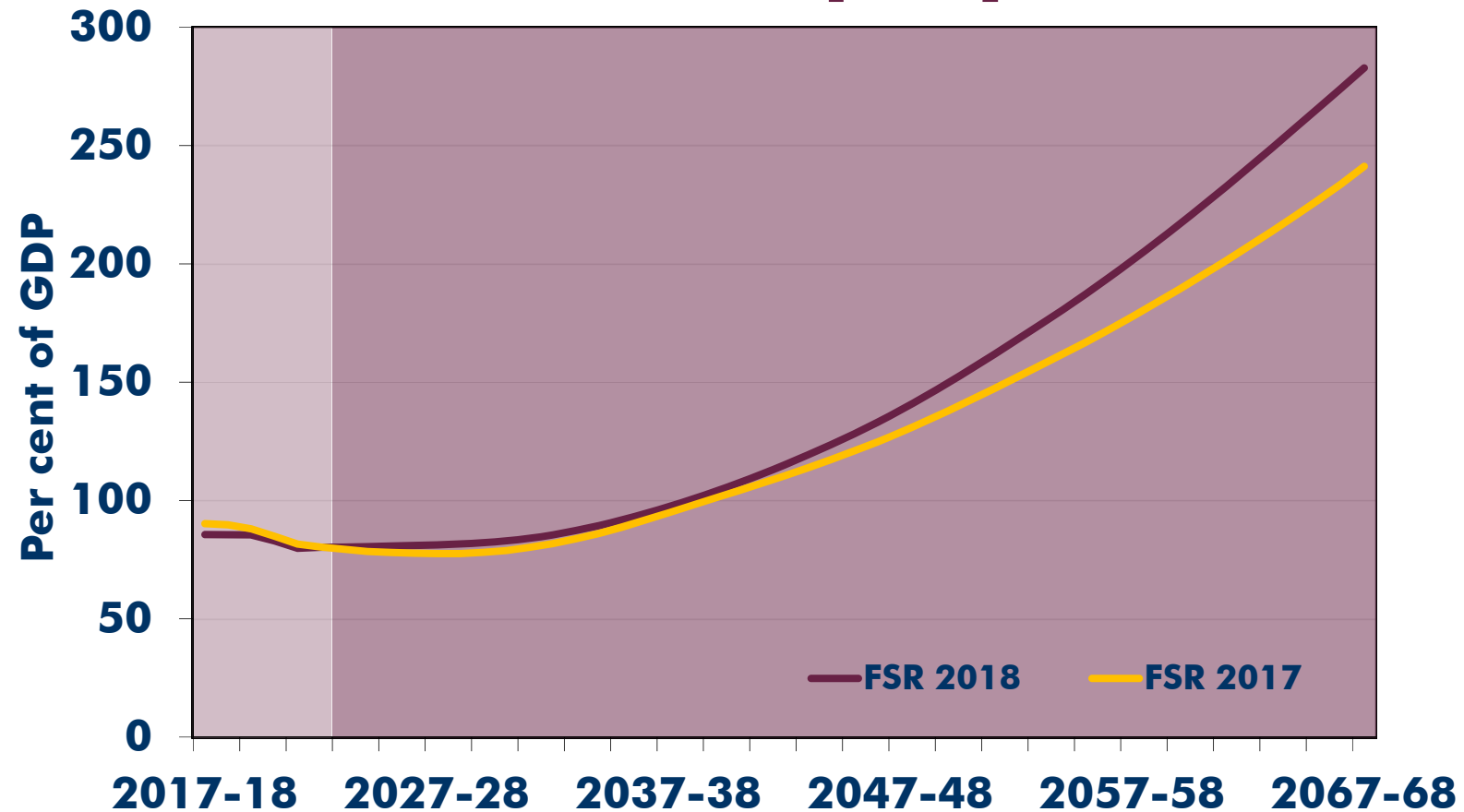
Targeting 40% debt-to-GDP ratio



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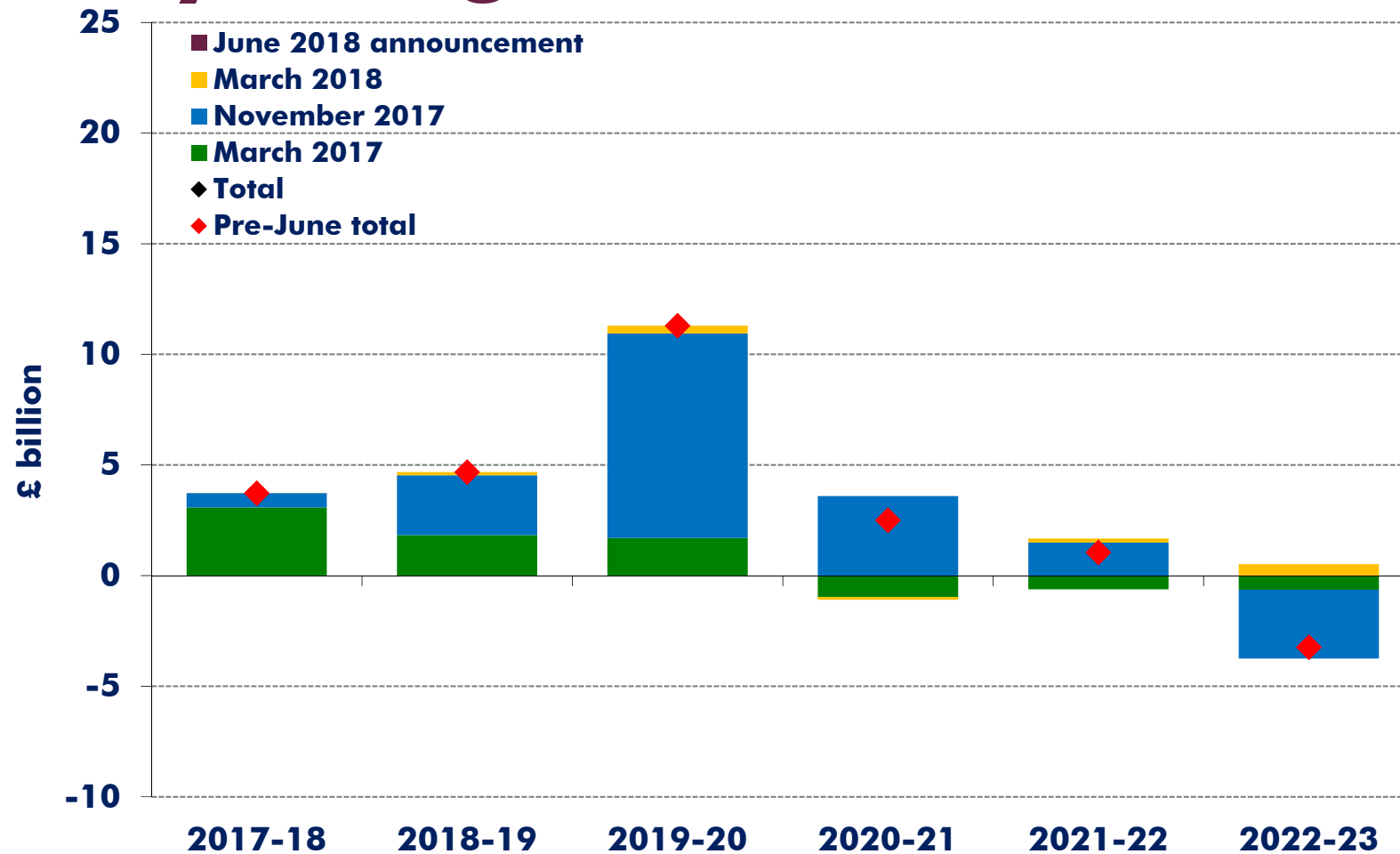
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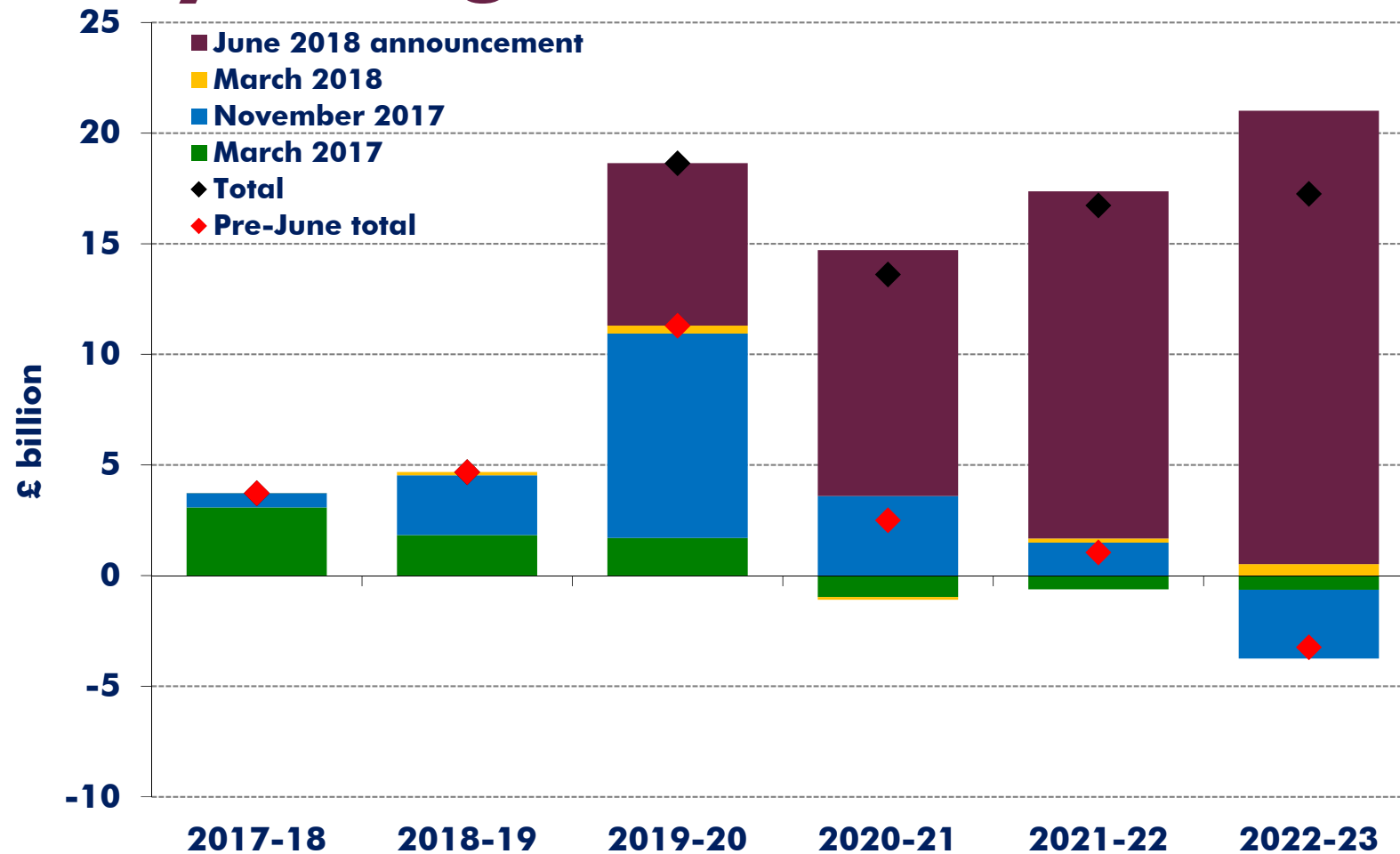
Changes since FSR 2017

Per cent of GDP in 2067-68	Primary balance	Net debt
FSR 2017	7.4	241.2
FSR 2018	8.6	282.8
Change	+1.3	+41.6
<i>of which:</i>		
Classification	0.0	-3.7
Medium-term and modelling	0.0	+9.5
Demography	+0.2	+8.9
Dilnot/SPA	-0.4	-31.0
June health announcement	+1.5	+57.9

Policy changes since FSR 2017



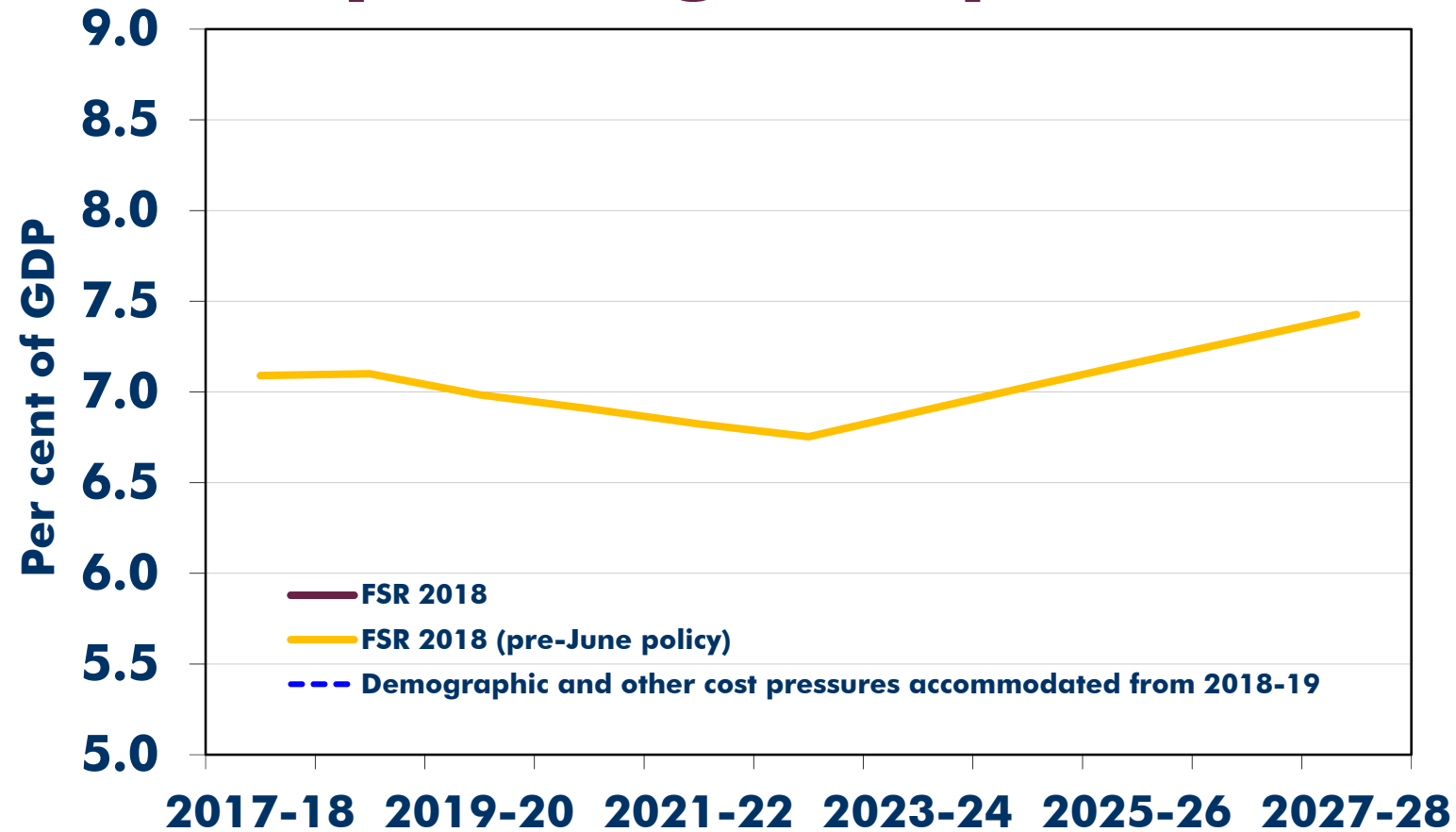
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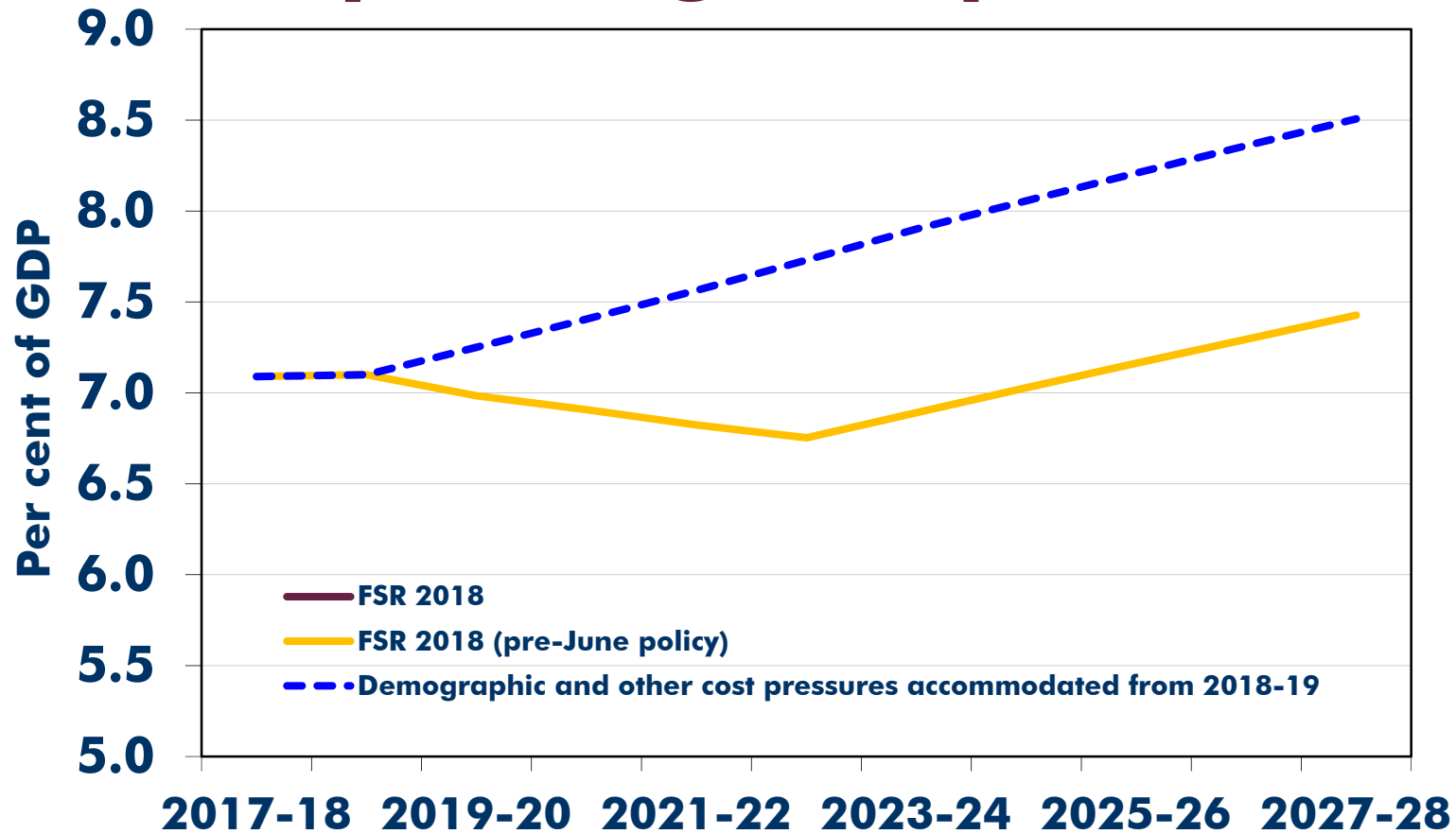
The June health announcement

- Increases spending by roughly £20bn in 2022-23 compared to what we would otherwise expect
- PM says it will be paid from a “Brexit dividend, with us as a country contributing a little more” – no more detail
- Brexit likely to weaken public finances overall
- Potential £13.3bn saving in direct budget contributions in 2022-23, but £7.5bn is needed for withdrawal settlement and the Government has made other commitments
- So we assume announcement adds to total spending and borrowing

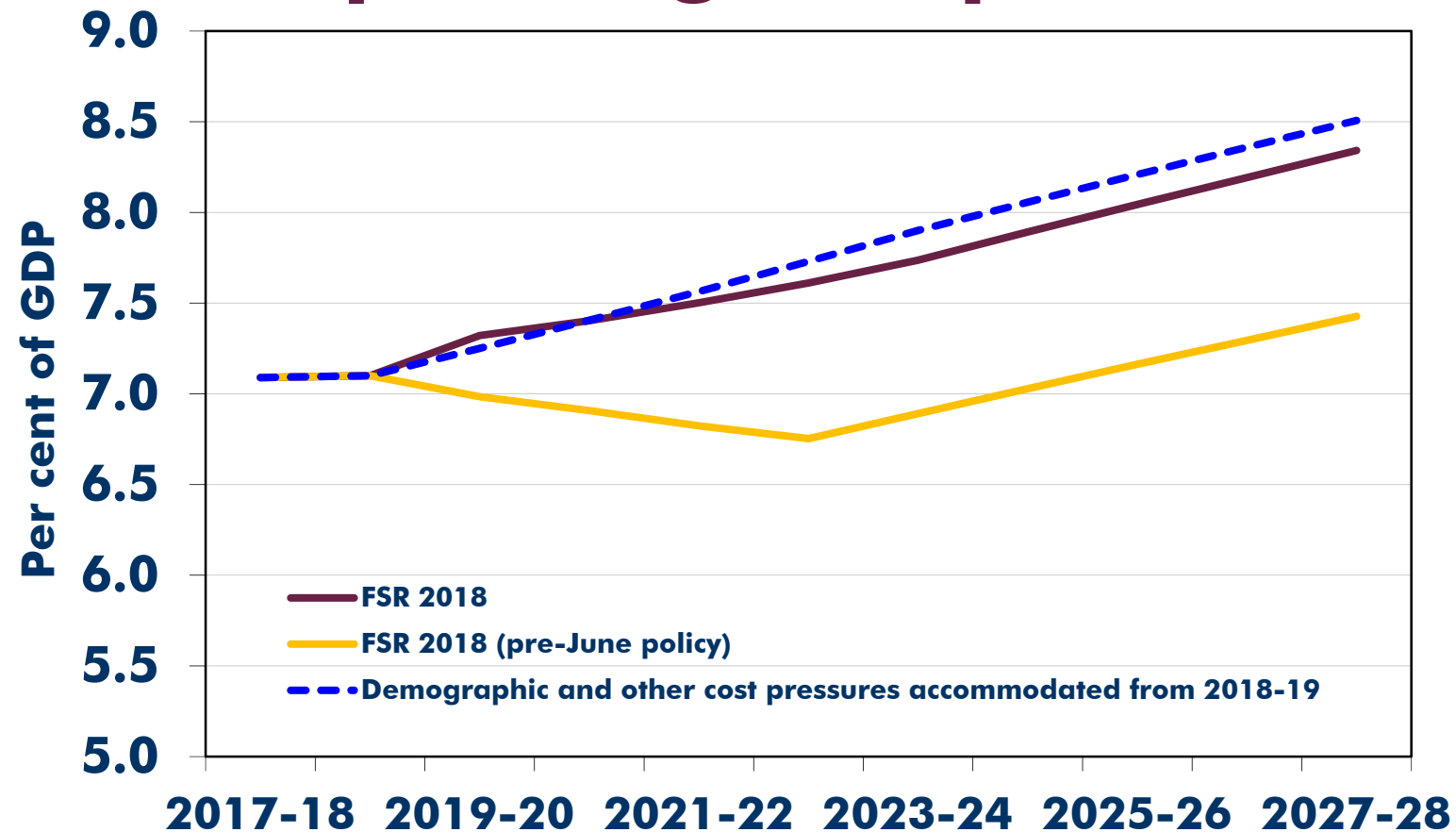
Health spending and pressures



Health spending and pressures



Health spending and pressures



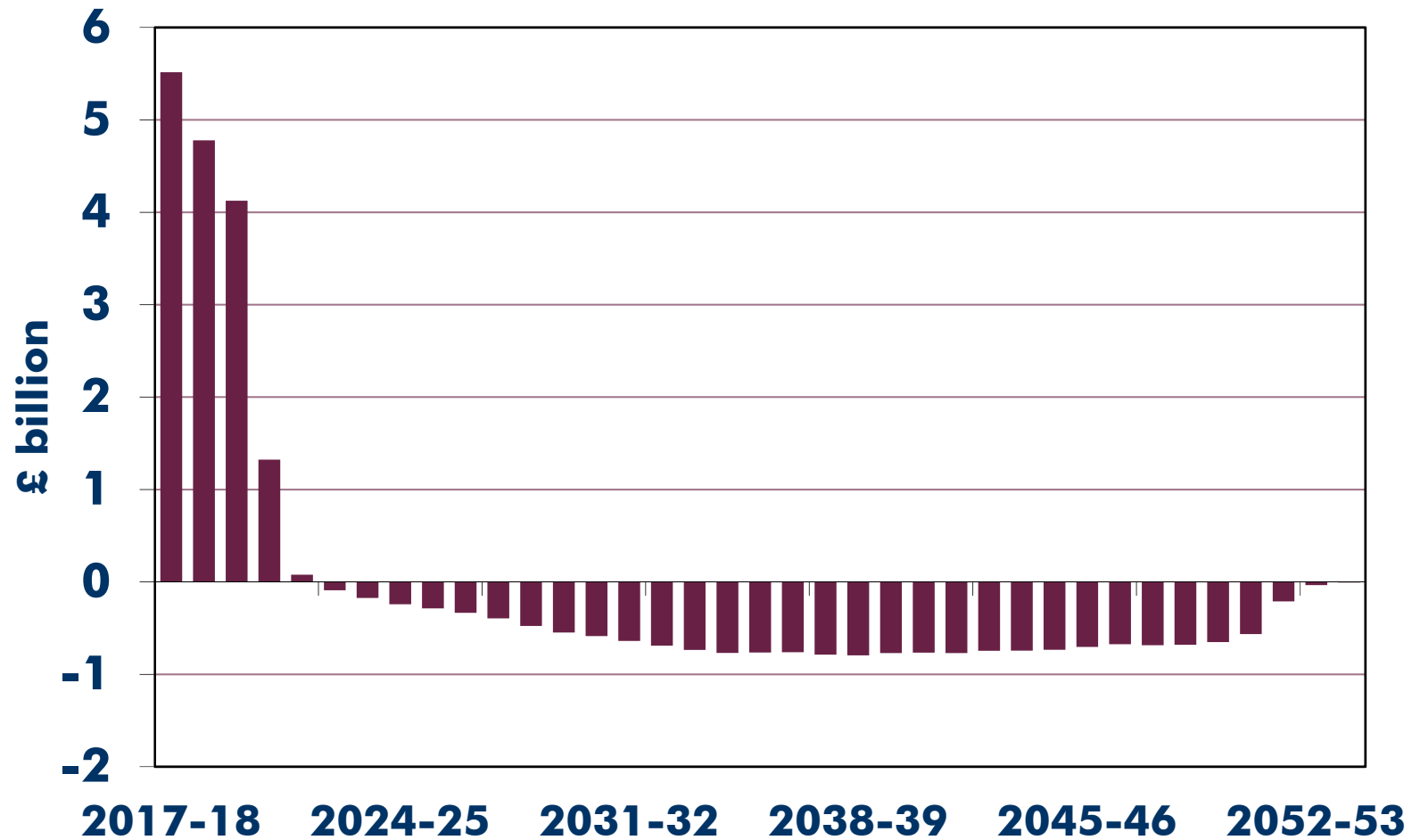
Long-term projections: summary

- Pressure from ageing and other health costs
- Common to most industrial countries
- Outlook worse than last year, thanks to demography and health announcement
- Outlook depends on live policy choices over social care, pensions uprating and health
- Further policy action likely to be necessary

Student loans and fiscal illusions

- Student loans are important to public finances
- Outlays rising to £19bn by 2022-23
- Loan book rising to 20% of GDP by 2040s
- But hard to capture meaningfully in fiscal aggregates as full impact takes more than three decades

Cash flows for 2017-18 cohort



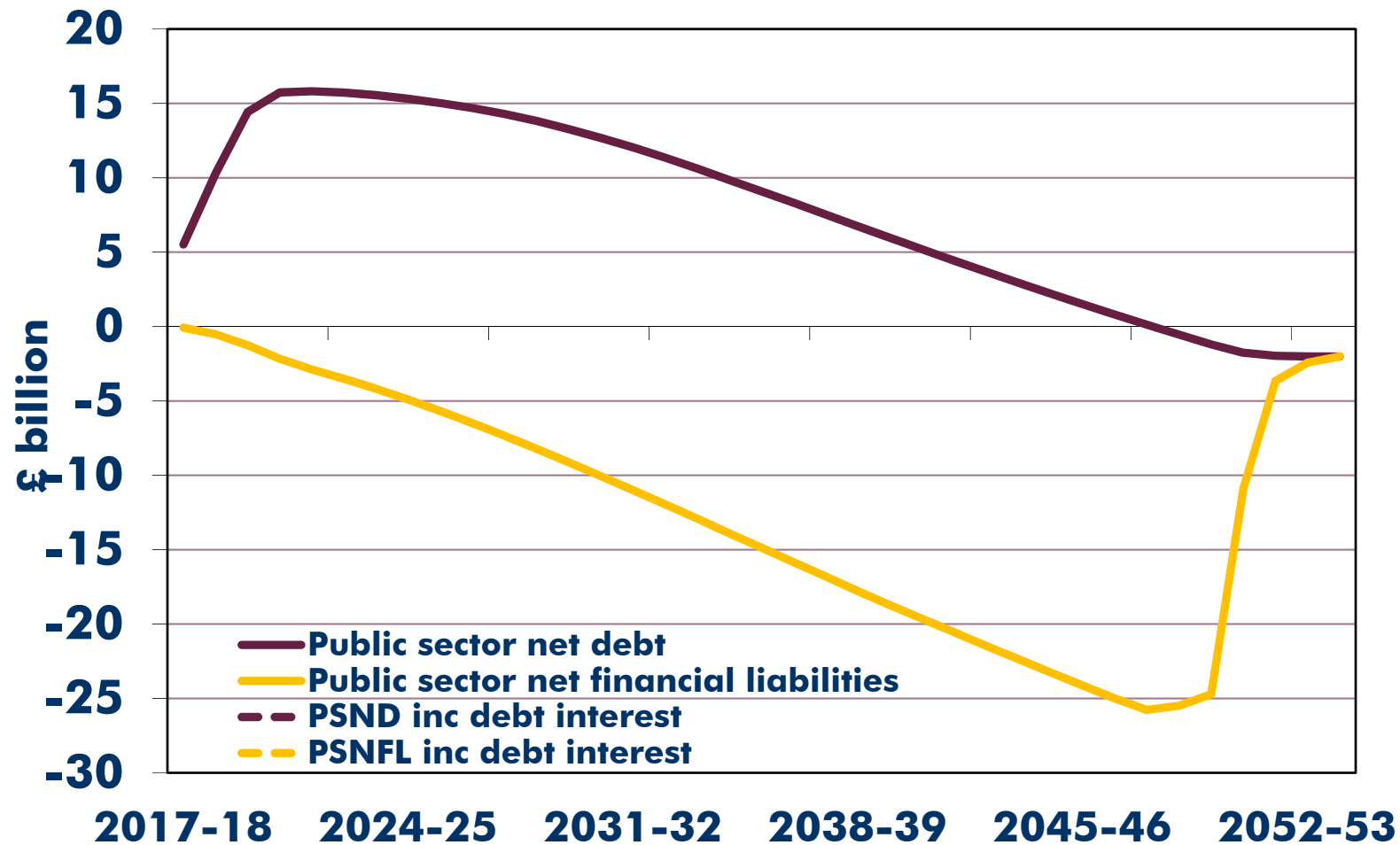
Student loans and fiscal illusions

- Public finance statistics comply with ESA10
- Student loans treated like other loans
- But repayments set at 9% on earnings above £25k and debt outstanding written off after 30 years
- Significant subsidy despite relatively high interest rate
- Government periodically sells loan book tranches

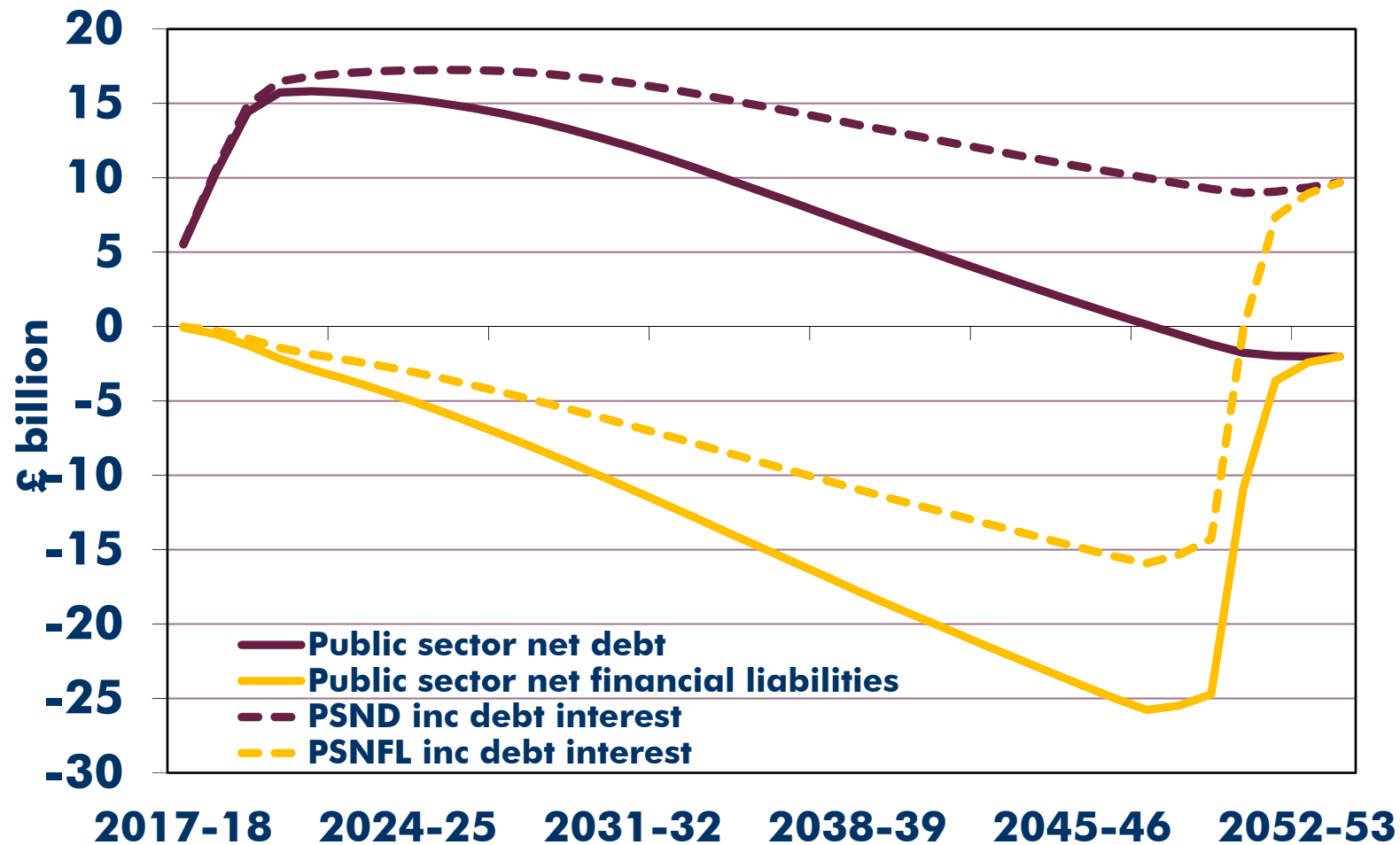
Current accounting treatment

	Loan extension	Capitalised interest	Cash repayments	Write offs
Public sector net debt	Increases	No impact	Decreases	No impact
Public sector net borrowing	No impact	Decreases	No impact	Increases
Public sector net financial liabilities	No impact	Decreases	No impact	Increases

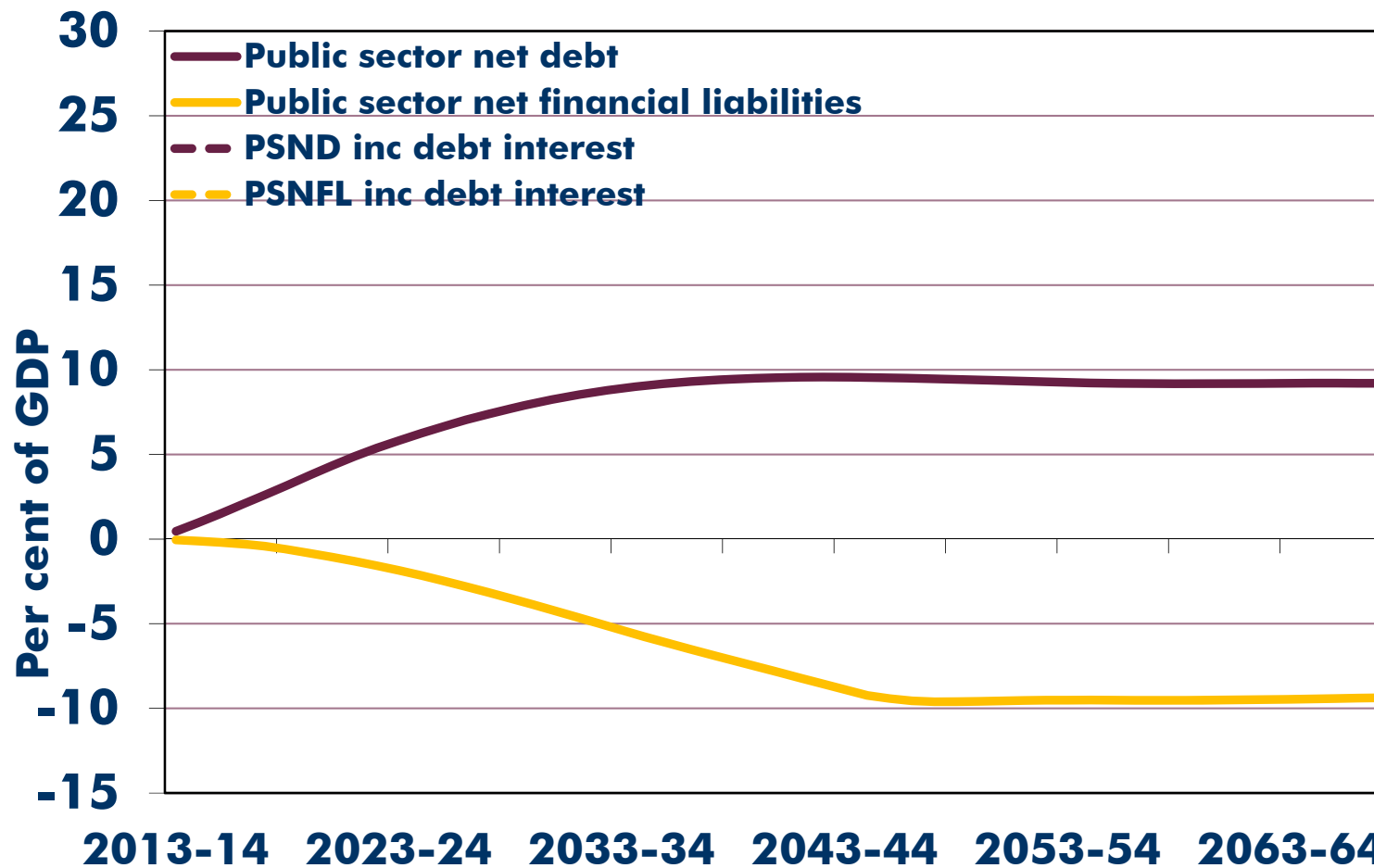
PSND and PSNFL: 2017-18 cohort



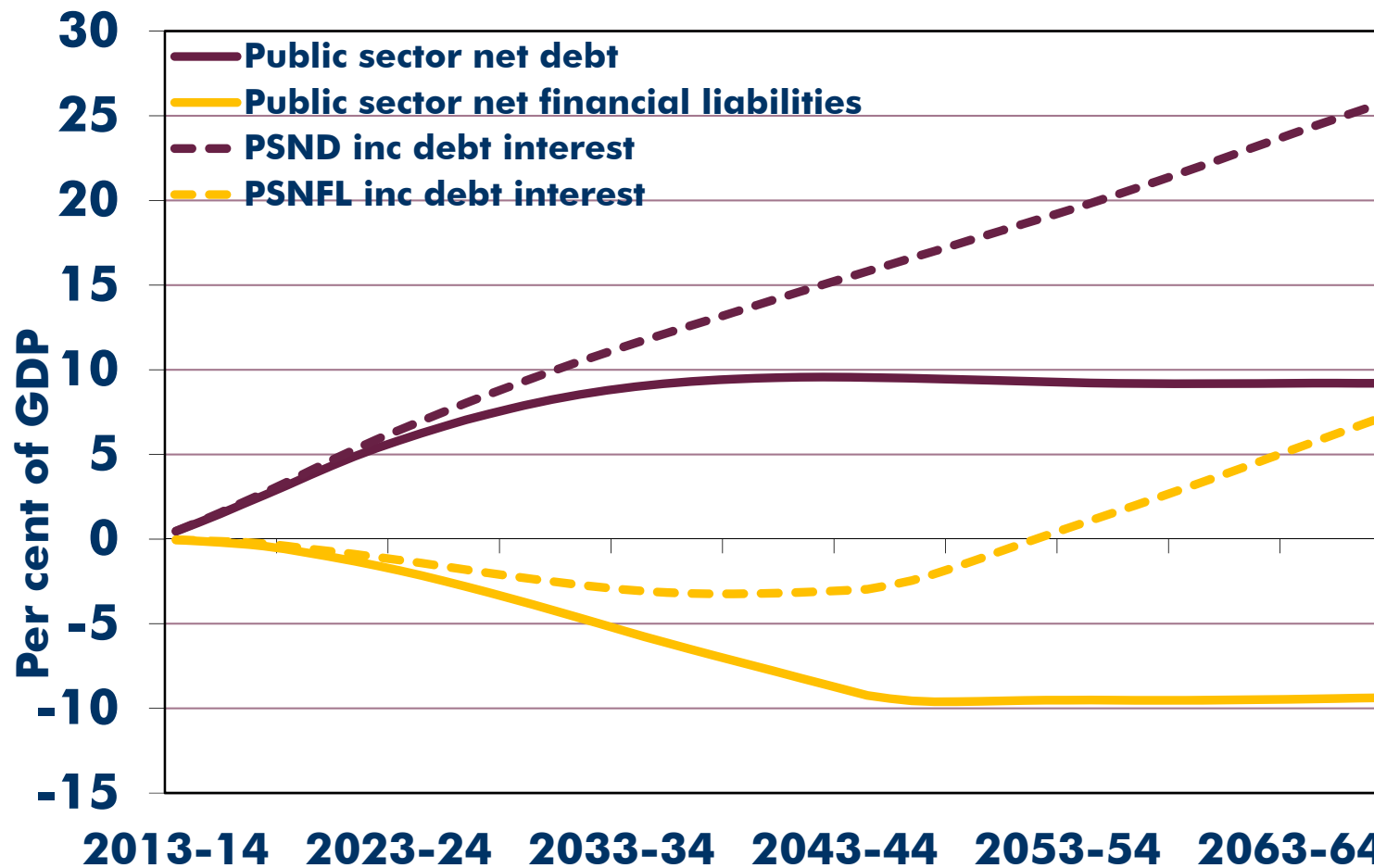
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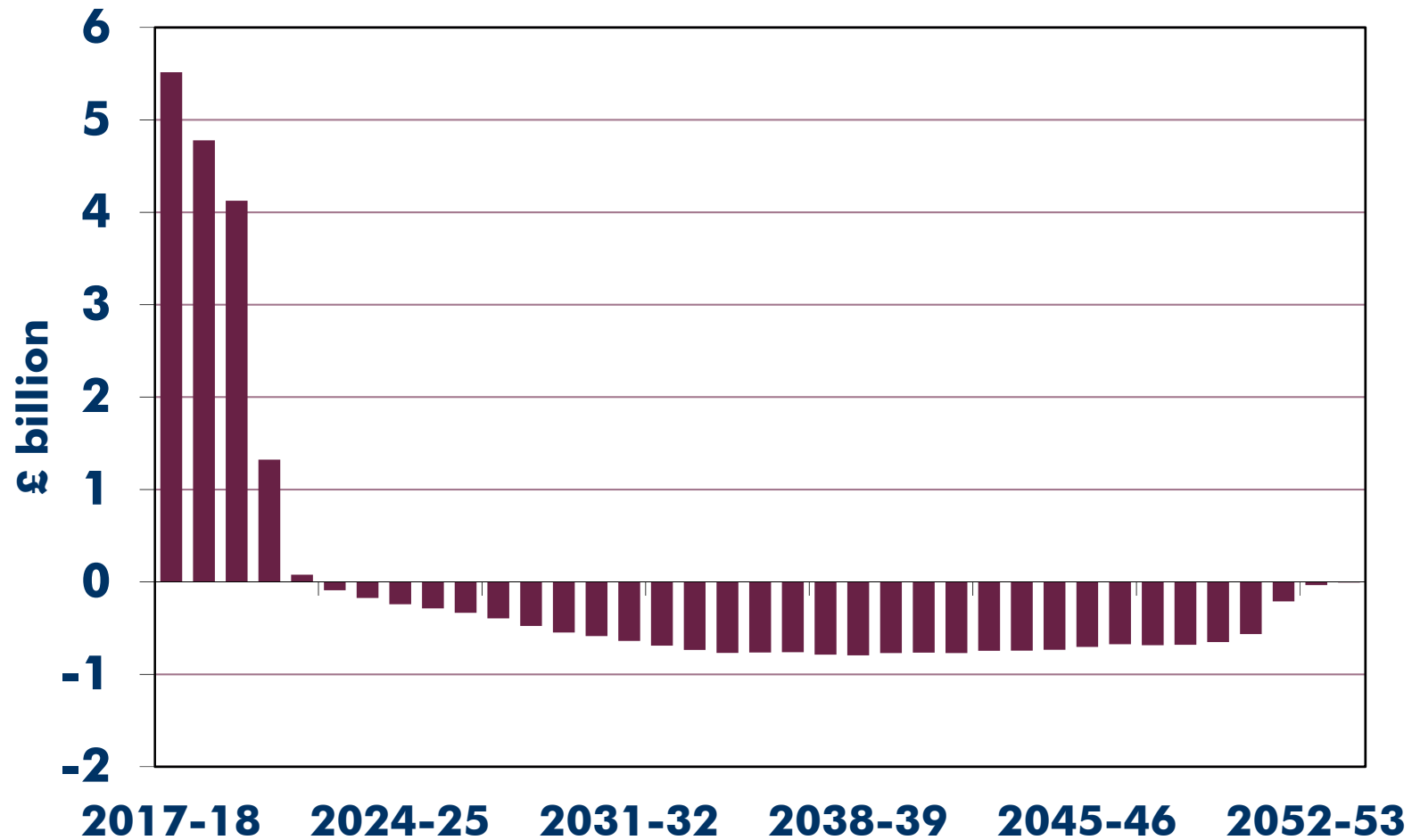
PSND and PSNFL: full loan book



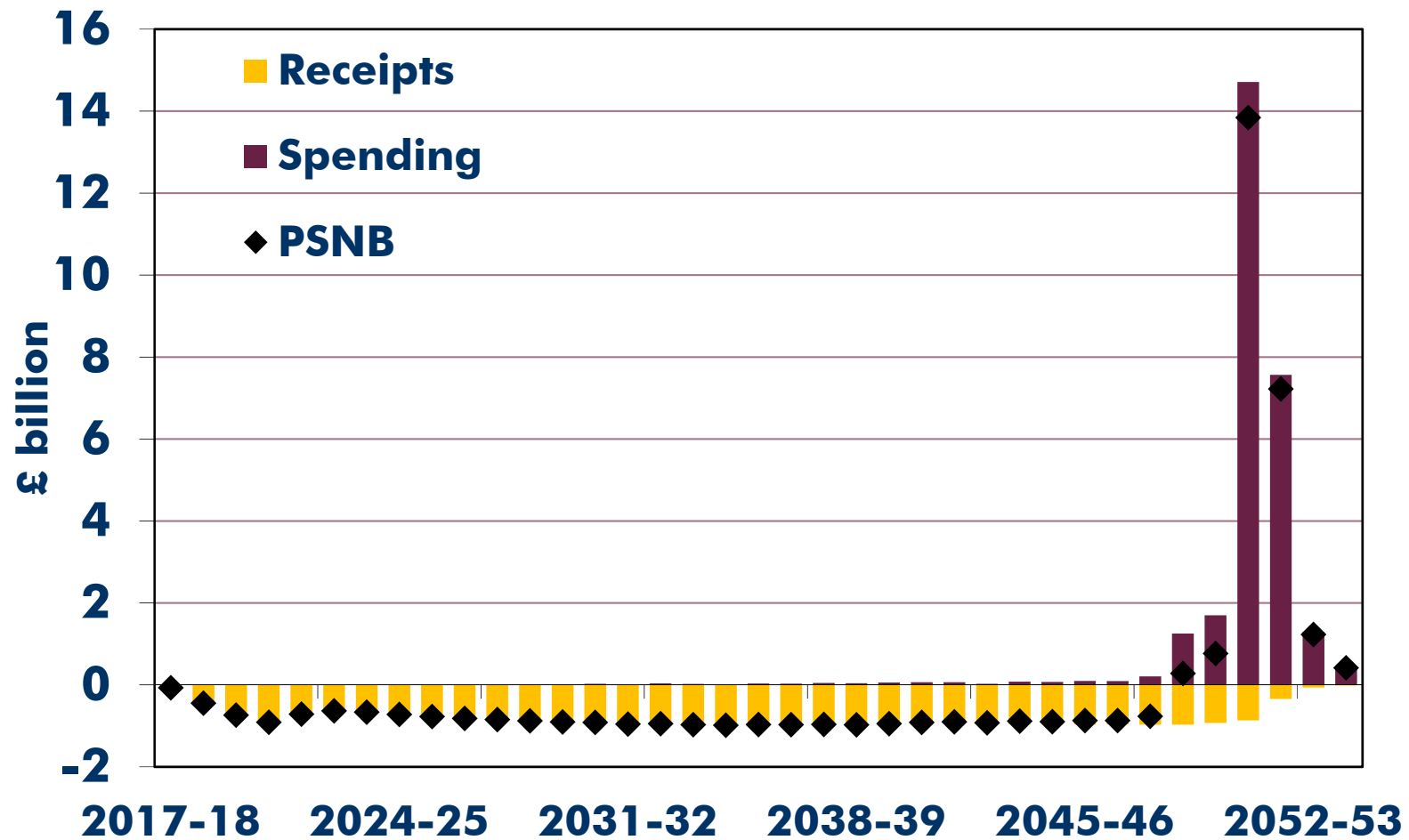
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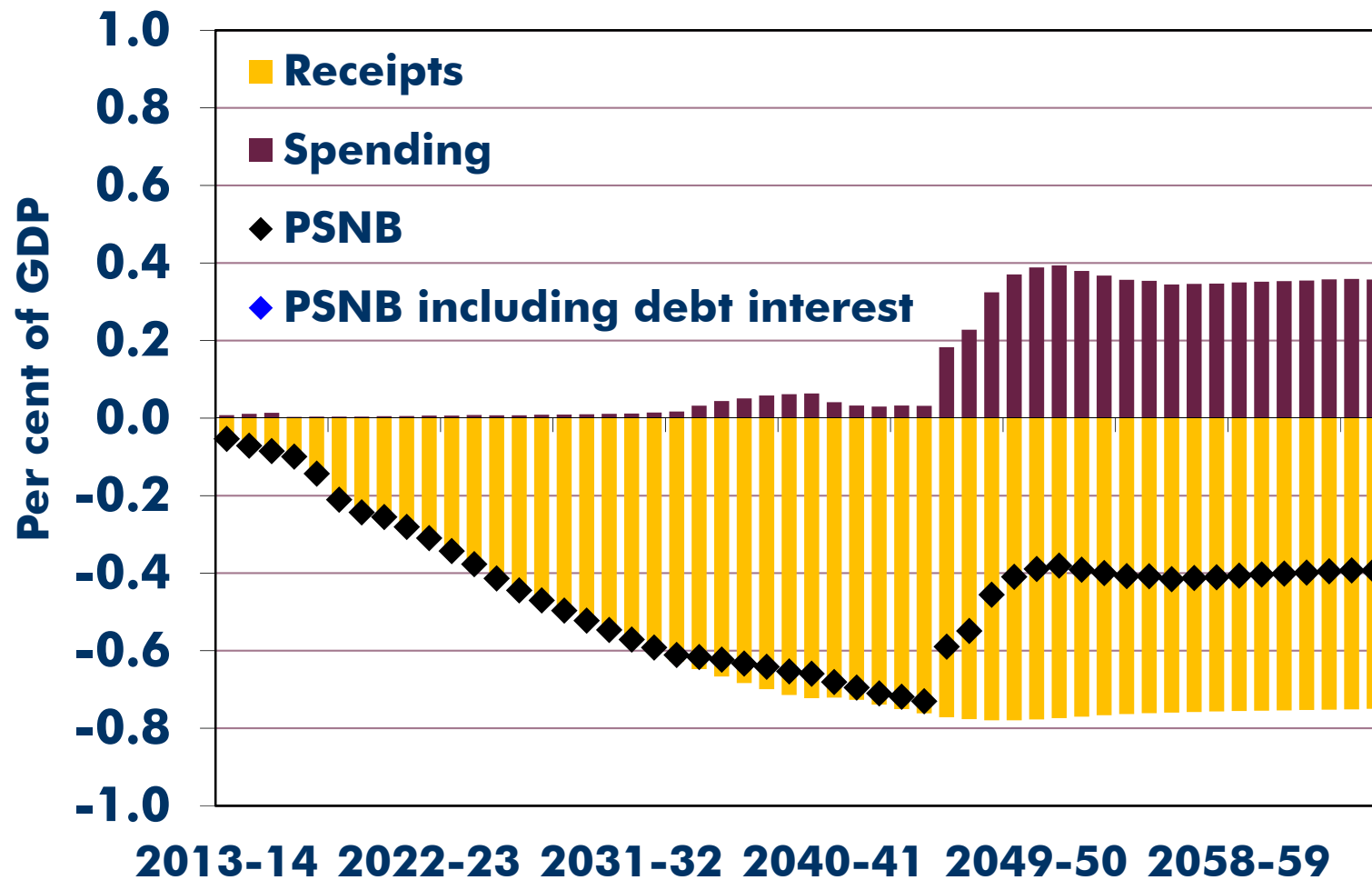
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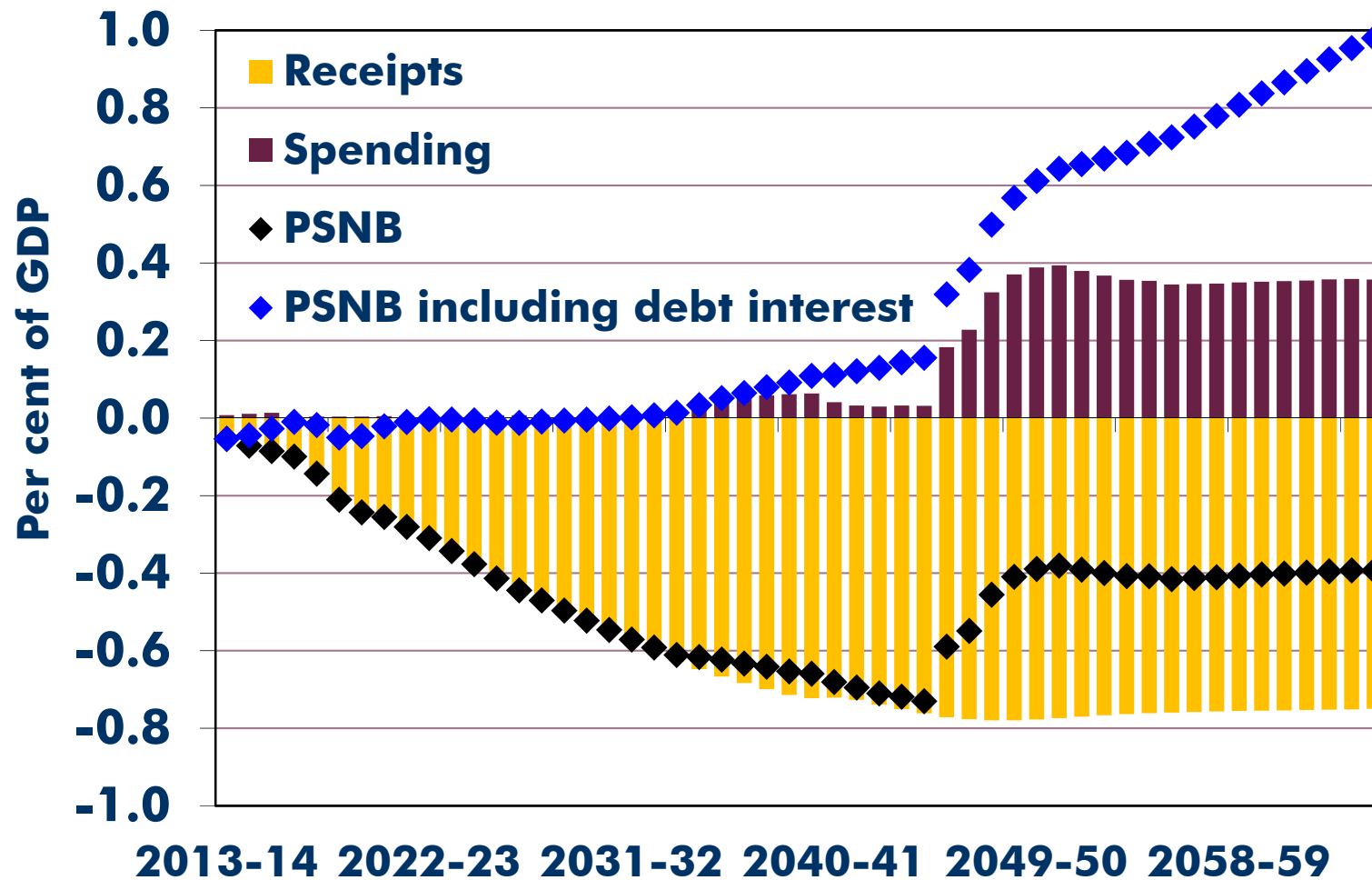
PSNB: 2017-18 cohort



PSNB: full loan book



PSNB: full loan book



Selling tranches of the loan book

- Selling loans lowers net debt, increases net financial liabilities and leaves net borrowing unaffected
- But selling loans means write-offs never hit the deficit, creating incentive to fund them this way
- Government says it is right to sell assets that have “achieved their original policy objective”
- But £12bn loan sales to 2020-21 will forego £23bn of future repayments
- Public benefit of sales not immediately obvious

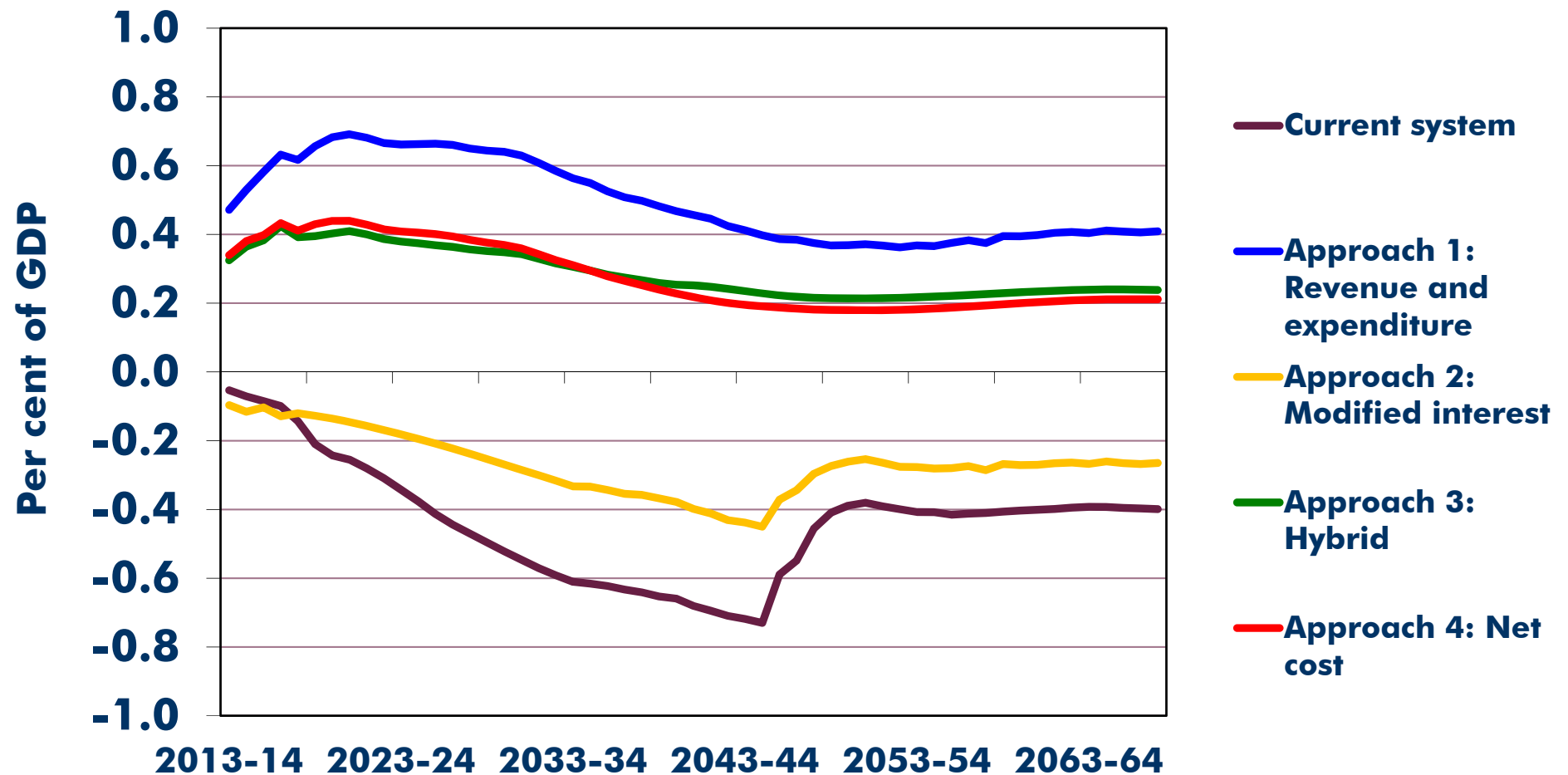
Desirable features of treatment

- Record expected losses up-front
- Only record income the government is likely to receive
- Maintain the convention that accruals treatment eventually equals cash treatment
- Remove perverse incentives to sell loan book

Options we examine

- Treat loans as grant spending plus taxes
- Avoid recording interest that will never be repaid
- Treat repaid loans as loans and others as grants
- Focus on cost to government, not loan terms
- Commercial accounting approach using NPVs

Options we examine: PSNB



Removing the fiscal illusion

