

22 June 2005

The following paper sets out the costs of converting the student loans scheme to an interest free scheme for borrowers in New Zealand. Borrowers not in New Zealand would still be charged interest at 7%.

This has been costed using two scenarios:

1. The entire student loans scheme would be interest free for all debt, current and future, from 1 January 2006
2. The student loans scheme would be interest free from 1 January 2006, interest would still apply to debt outstanding at 31 December 2005.

The costs are set out in two forms:

- The first is the estimated impact on gross debt. This is the amount that, assuming no other changes in flows (receipts) or outflows (payments), will shift the government's debt track.
- The second is the estimated impact on the operating balance – this is the amount by which, assuming no other changes in revenue or expenses, the government's operating surplus will decrease.

We have assumed that while there will be no increases in tertiary participation, there will be increases in draw downs by students eligible to draw down loans who are not doing so under current policy settings.

The draw-down increases are lagged over a four year period as set out below:

	% of loan eligible students drawing down their full entitlement				
	2004/05	2005/06	2006/07	2007/08	2008/09 & outyears
<b>Fees</b>					
Full time	69%	79%	85%	90%	95%
Part time	13%	20%	30%	35%	40%
<b>Living Costs</b>					
Full time only	41%	55%	65%	70%	75%
<b>Course Costs</b>					
Full time	47%	60%	70%	77%	85%
Part time	10%	18%	22%	27%	30%

In the final year draw down rates do not reach 100%, and given the generous nature of this policy change this assumption may be understating the total cost.

**Student loan scheme changes – interest free for all participants:**

Year	\$ million	\$ million	\$ million	\$ million	\$ million
	Annual operating balance impact including interest	Cumulative gross debt impact including interest	Increase in cumulative gross debt as a % of GDP	Previous year end closing balance	Interest free scenario year end closing balance
2005/06	179	291	0.19%	7,195	7,307
2006/07	237	819	0.51%	7,802	8,204
2007/08	311	1,532	0.90%	8,422	9,227
2008/09	390	2,420	1.36%	9,046	10,349
2009/10	397	3,329	1.78%	9,546	11,361
2010/11	450	4,238	2.17%	10,018	12,292
2011/12	503	5,129	2.52%	10,494	13,156
2012/13	556	6,062	2.86%	10,969	14,008
2013/14	609	7,047	3.19%	11,430	14,845
2014/15	663	8,084	3.51%	11,880	15,670
2015/16	718	9,179	3.83%	12,317	16,483
2016/17	769	10,315	4.14%	12,763	17,297
2017/18	814	11,458	4.42%	13,258	18,121
2018/19	868	12,676	4.70%	13,741	18,953
2019/20	924	13,956	4.97%	14,214	19,781

**Student loans scheme – interest free for all participants from 1 January 2006, interest still applying to debt outstanding at 31 December 2005:**

Year	\$ million	\$ million	\$ million	\$ million	\$ million
	Annual operating balance impact including interest	Cumulative gross debt impact including interest	Increase in cumulative gross debt as a % of GDP	Previous year end closing balance	Interest free scenario year end closing balance
2005/06	(19)	173	0.11%	7,195	7,387
2006/07	(9)	604	0.37%	7,802	8,434
2007/08	96	1,291	0.76%	8,422	9,645
2008/09	206	2,166	1.22%	9,046	10,937
2009/10	240	3,062	1.64%	9,546	12,094
2010/11	313	3,958	2.03%	10,018	13,148
2011/12	383	4,836	2.38%	10,494	14,120
2012/13	455	5,757	2.71%	10,969	15,060
2013/14	523	6,729	3.04%	11,430	15,971
2014/15	590	7,752	3.37%	11,880	16,855
2015/16	657	8,835	3.69%	12,317	17,717
2016/17	718	9,958	3.99%	12,763	18,570
2017/18	772	11,088	4.27%	13,258	19,422
2018/19	833	12,293	4.55%	13,741	20,276
2019/20	894	13,560	4.83%	14,214	21,122

**Assumptions:**

**All:**

- Participation in tertiary education is capped at BEFU 2005 levels, and grows only by projected demographic change beyond 2009.
- The assumed interest rate is the government's 10 year bond rate.
- The start date of this policy would be 1 January 2006

**Student loans:**

- Average fees are \$4,300 in 2006 (based on actual historical draw downs).
- Fee growth is 3.6% p.a on average (this is a weighted average of the historical 4% TEI increase, and the 3% increase that PTEs are limited to).
- Course costs are \$1,000 and do not grow in this model. Entitlements for course costs have not changed since 1992 (except for a one year period where the entitlement fell to \$500) and increasing the entitlement would most likely be a discretionary step change in the order of \$500 – this is why there is no CPI adjustment.
- The TESLA output has been altered to match the current track in the LTFM (which is a function of the IRD track in the years 2005/06 to 2008/09).

**Receipts:**

- Interest accrued on those students overseas is assumed to be 6.6% of outgoings – this is a function of the 12% of debt that is overseas at any one time, adjusted for the fact that 45% of that 12% is an overdue debt with the IRD.
- The interest rate for those overseas is the current student loan interest rate of 7%
- Voluntary repayments will cease (under this scheme there is an incentive to repay debt as slowly as possible).

27 June 2005

You have asked us to provide a costing of providing an interest free student loans scheme, using altered assumptions around draw down rates and voluntary repayments.

The previous costing provided to you on 22 June 2005 used an assumption of voluntary repayments ceasing, and draw down rates increasing to the following levels:

	% of loan eligible students drawing down their full entitlement				
	2004/05	2005/06	2006/07	2007/08	2008/09 & outyears
<b>Fees</b>					
Full time	69%	79%	85%	90%	95%
Part time	13%	20%	30%	35%	40%
<b>Living Costs</b>					
Full time only	41%	55%	65%	70%	75%
<b>Course Costs</b>					
Full time	47%	60%	70%	77%	85%
Part time	10%	18%	22%	27%	30%

This changed estimate assumes that voluntary repayments will continue at the rate at which they occur under the current scheme, the percentage of the \$150 entitlement for living costs drawn done does not increase, and draw down rates increase in the following manner:

	% of loan eligible students drawing down their full entitlement				
	2004/05	2005/06	2006/07	2007/08	2008/09 & outyears
<b>Fees</b>					
Full time	69%	70%	70%	70%	70%
Part time	13%	13%	13%	13%	13%
<b>Living Costs</b>					
Full time only	41%	44%	47%	49%	50%
<b>Course Costs</b>					
Full time	47%	52%	56%	59%	60%
Part time	10%	12%	14%	16%	18%

We have provided estimates of two scenarios:

1. The entire student loans scheme would be interest free for all debt, current and future, from 1 January 2006
2. The student loans scheme would be interest free from 1 January 2006, interest would still apply to debt outstanding at 31 December 2005.

**Student loan scheme changes – interest free for all participants – changed assumptions:**

Year	\$ million	\$ million	\$ million	\$ million	\$ million
	Annual operating balance impact including interest	Cumulative gross debt impact including interest	Increase in cumulative gross debt as a % of GDP	Previous year end closing balance	Interest free scenario year end closing balance
2005/06	171	32	0.02%	7,195	7,056
2006/07	209	103	0.06%	7,802	7,525
2007/08	257	195	0.11%	8,422	7,979
2008/09	302	299	0.17%	9,046	8,406
2009/10	273	438	0.23%	9,546	8,772
2010/11	293	622	0.32%	10,018	9,135
2011/12	319	835	0.41%	10,494	9,505
2012/13	346	1,070	0.50%	10,969	9,868
2013/14	374	1,326	0.60%	11,430	10,212
2014/15	402	1,602	0.70%	11,880	10,537
2015/16	430	1,906	0.79%	12,317	10,847
2016/17	454	2,216	0.89%	12,763	11,150
2017/18	472	2,497	0.96%	13,258	11,454
2018/19	499	2,816	1.04%	13,741	11,757
2019/20	527	3,165	1.13%	14,214	12,051

**Student loans scheme – interest free for all participants from 1 January 2006, interest still applying to debt outstanding at 31 December 2005 – changed assumptions:**

Year	\$ million	\$ million	\$ million	\$ million	\$ million
	Annual operating balance impact including interest	Cumulative gross debt impact including interest	Increase in cumulative gross debt as a % of GDP	Previous year end closing balance	Interest free scenario year end closing balance
2005/06	(39)	30	0.02%	7,195	7,264
2006/07	(67)	100	0.06%	7,802	8,007
2007/08	(10)	191	0.11%	8,422	8,729
2008/09	51	295	0.17%	9,046	9,407
2009/10	55	435	0.23%	9,546	9,991
2010/11	105	618	0.32%	10,018	10,542
2011/12	154	831	0.41%	10,494	11,076
2012/13	202	1,066	0.50%	10,969	11,584
2013/14	244	1,321	0.60%	11,430	12,057
2014/15	285	1,597	0.69%	11,880	12,499
2015/16	324	1,901	0.79%	12,317	12,914
2016/17	360	2,211	0.89%	12,763	13,311
2017/18	386	2,492	0.96%	13,258	13,701
2018/19	420	2,811	1.04%	13,741	14,083
2019/20	453	3,159	1.13%	14,214	14,451

**Assumptions:**

**All:**

- Participation in tertiary education is capped at BEFU 2005 levels, and grows only by projected demographic change beyond 2009.
- The assumed interest rate is the government's 10 year bond rate.
- The start date of this policy would be 1 January 2006

**Student loans:**

- Average fees are \$4,300 in 2006 (based on actual historical draw downs).
- Fee growth is 3.6% p.a on average (this is a weighted average of the historical 4% TEI increase, and the 3% increase that PTEs are limited to)
- Course costs are \$1,000 and do not grow in this model. Entitlements for course costs have not changed since 1992 (except for a one year period where the entitlement fell to \$500) and increasing the entitlement would most likely be a discretionary step change in the order of \$500 – this is why there is no CPI adjustment.
- The TESLA output has been altered to match the current track in the LTFM (which is a function of the IRD track in the years 2005/06 to 2008/09).

**Receipts:**

- Interest accrued on those students overseas is assumed to be 6.6% of outgoings – this is a function of the 12% of debt that is overseas at any one time, adjusted for the fact that 45% of that 12% is an overdue debt with the IRD.
- The interest rate for those overseas is the current student loan interest rate of 7%
- Voluntary repayments remain at the same level as under the current scheme.

SH-4-4-6

13 September 2005

John Belgrave  
Chief Ombudsman  
Level 14  
70 The Terrace  
PO Box 10152

Dear John

You have recently initiated an urgent inquiry into the decision of the Minister of Finance to withhold information relating to the Official Information Act request from Nicola Willis of the National Party Research Unit regarding "All advice prepared in relation to the Government's policy proposal to abolish all interest charges on student loans for those who reside in New Zealand".

In the event that you form a view that the Treasury papers captured by this request should be released, I thought it would be helpful to clarify the status of the costings set out in the papers, so that any comments associated with their release are factually accurate. Namely, they represent broad cost estimates of different student support scenarios and were intended to provide the Minister with a sense of the order of magnitude of different policy options rather than formal Treasury costings of particular student support policies.

This is important because should any of these policy options, including the policy to remove interest on all student loans, be presented for active consideration as government policy in the future, the Treasury would need to undertake a more formal exercise to cost the policy. I cannot say at this stage whether this would result in a higher or lower cost of that policy, or how significant the magnitude of these changes might be.

As you know, the Treasury was asked by the Minister of Finance to provide estimates of the fiscal costs of various scenarios involving changes to student support over a period of five weeks or so. Those scenarios costed later in this time period related to a policy to remove all interest on student loans. Such requests are not uncommon in the preliminary stages of policy development, where Ministers are interested in getting a sense of the order of magnitude of different options. In this case, we were also asked to provide these cost estimates with relatively short turnaround times. Accordingly, we were constrained in the information we could bring to bear and had to limit the extent to which we involved other agencies in developing and testing the assumptions and costings.

The status of the costings is captured in our first email to the Minister's office of 9 June 2005, in which we stated: "This estimate is rudimentary and can only be relied upon to show the order of magnitude of costs." We reinforced this qualification in our email to the Minister's office of 22 June where we describe the costing as "rudimentary" and "basic".

To provide some context for these comments, I thought it would be useful to set out the approach that was adopted in producing the cost estimates, and identify the nature and scope of the refinements that would be expected in order to produce an acceptable policy costing.

First, the cost estimates were produced assuming that all existing student loan policy parameters remained unchanged. In practice, when designing a policy such as removing interest on student loans, Ministers have a number of parameters they can adjust depending on their policy objectives. These include (but are not limited to) loan eligibility criteria, term limits that may be placed on the loan, restrictions on access to tertiary education, and changes to income repayment thresholds. Once the broad direction of policy is agreed, we would expect Ministers to make decisions on the parameters as part of the normal government policy development process. These policy details can potentially have a significant impact on the costs of a proposal.

Secondly, we were unable to use the full resources we would normally draw on to cost such policies. In this instance time constraints meant that the Ministry of Education was only able to use the Tertiary Education Student Loan Analysis (TESLA) model for some of the variations, and some estimates (including those for the policy to remove interest on student loans) had to be done using TESLA data, but outside of the TESLA model.

Thirdly, the cost estimates do not include any estimate of the implementation costs associated with the design, development, or delivery of the policies.

In addition, the earlier cost estimates were produced within the Treasury without consulting any other agencies, while for the later estimates (including the cost of removing interest on student loans) consultation was limited to the Ministry of Education. This meant that we were not able to access other key information, such as the Inland Revenue Department's data relating to the Student Loans Scheme, or the Student Loans Fair Value model currently under construction. These information tools would be used to more accurately cost policy changes of this nature.

Finally, none of the cost estimates were subjected to the full range of internal quality assurance mechanisms we would normally use to test assumptions, such as sensitivity analysis.

I understand the Minister of Finance has also expressed his concerns to you that the release of costings such as these, prepared in the formative stages of policy development as a way of helping Ministers shape the direction of policy, may deter Ministers from asking Treasury for this type of exploratory information in the future, to the detriment of the quality of policy decision-making. You will no doubt consider this in your deliberations.



I trust you find this information useful in the context of your current investigation.  
Please feel free to contact me directly should you have any questions on the issues raised in this letter.

Yours sincerely,

John Whitehead  
Secretary to the Treasury