

Reference: 20170386

20 December 2017



Thank you for your Official Information Act request, received on 22 November 2017.
You requested the following:

"I request a copy all advice provided to either the Minister of Education or the Minister of Finance regarding the costings of the following policies:

- Changes to the tertiary student support systems, including changes to the student loan and student allowance systems.*
- Changes to the tuition fees tertiary students pay, including the change to allow fees-free tertiary tuition for students in their first year of study."*

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	8 November 2017	Aide Memoire: Ministerial group meeting on making tertiary education and training affordable for all	Release in part
2.	15 November 2017	Aide Memoire: Cabinet paper seeking decisions to support making tertiary education and training affordable for all	Release in part
3.	16 November 2017	Aide Memoire: Fiscal implications of tertiary education changes	Release in part
4.	24 November 2017	Treasury Report: Final Decisions on Tertiary Education Changes	Release in part

I have decided to release the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- staff direct telephone numbers, under section 9(2)(k) – to prevent the disclosure of official information for improper gain or improper advantage.

The documents show various figures for the overall policy costings for fees-free and student support increases. This reflects the fact that the scope and design of the policy was being shaped by Ministers as decisions were being made and as the Ministry of Education undertook a complex costings process. The Ministry of Education is also proactively releasing material relating to tertiary education policy changes.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Diana Cook
Manager, Education and Skills

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Reference: T2017/2438

SH-4-6-4

Date: 8 November 2017



To: Minister of Finance (Hon Grant Robertson)
cc: Associate Minister of Finance (Hon Dr David Clarke)

Deadline: 4.30pm, Wednesday 8 November

Aide Memoire: Ministerial group meeting on making tertiary education and training affordable for all**Purpose**

You are meeting with the Ministers of Education, Social Development, and Revenue, and Associate Minister of Education at 4.30pm on Wednesday 8 November to discuss the following:

- a Cabinet paper for 13 November seeking final policy decisions on the \$50 weekly increase to student loans and allowances, and
- an initial briefing on delivery channel options for fees-free education and training in 2018.

This briefing provides you with our view of the initial policy costings, our recommended approach to provide Cabinet with sufficient information on the fiscal implications of the policy decisions, and our advice on the policy decisions sought in the Ministerial meeting.

Policy Costings*Fees-free policy*

The Ministry of Education has provided us with a range of detailed information regarding the policy costings for the fees-free policy. We are continuing to work through this material, but our initial assessment is that the approach taken to the costings is robust and we are confident that we can provide assurance ahead of the submission of the relevant Cabinet paper scheduled for 27 November.

Increases to student support policy

The Ministry has provided initial costings of increasing student support living costs by \$50 per week:

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	Average cost per annum (\$million) ¹	
	Low estimate	High estimate
Gross Student Allowance cost	75	125
Student loans living cost (cash cost)	60	100
Student loans living cost - initial fair value write-down cost ²	30	55
Gross amount	135	225

We have not yet received the same level of information for these costings. The Ministry has provided a range of high and low estimates based on initial assumptions as there is still uncertainty around the costings. We have not yet been able to assess the validity of this range. It is possible that the final costings may be at the higher end of the range or exceed it. When there is this uncertainty, it is appropriate for the Cabinet paper recommendations to be based on the top of the range to reduce the risk that the final figure exceeds the one on which Cabinet based its decision. This is the approach taken in the Cabinet paper as currently drafted.

While policy costings are part of the core roles of departments, Treasury will continue to engage with the Ministry to ensure that we are in a position to provide an appropriate level of quality assurance as soon as possible. At this stage, we have been provided with the basic assumptions on which the Ministry is basing its work. Our main two comments at this stage are:

- The costings assume projected 2018 student numbers whereas the costings for the fees-free policy assume 2016 student numbers. We do not believe there is a sound rationale for costing the two policies using different student numbers
- The costings are an average over the forecast period, and we understand that the cost profile is higher in the early years and lower in the later years. This will be important for the OBEGAL impact.

Approach to Fiscal Implications

Confirmation of decisions on the policy to increase student support by \$50 per week is required at next week's Cabinet meeting because MSD needs to start IT system changes to implement the policy by 1 January 2018. We understand that the current timelines to complete this work are compressed, with the usual time required being halved to ensure timely implementation.

¹ Figures are based on prelim HYEPU.

² The initial fair value write-down is the difference between the nominal amount lent and the fair value on initial recognition. The difference arises mainly due to no interest on loans to domestic based borrowers being charged and no repayments required from those with very low incomes.

IN-CONFIDENCE*Impact on Labour's Fiscal Plan and forecasts*

Before these costings are finalised, the following will be required:

- Cabinet agreement to the Budget Strategy and the allowances on 20 November, and
- The Treasury will require fiscal forecasts (including the 100 Day Plan costings) from agencies in preparation for Half Year Economic and Fiscal Update (HYEFU) by 27 November.

Initial costings of both the tertiary education policies, alongside other costings of individual policies in the 100 Day Plan, will be used to inform the Budget allowances. Any variance to net fiscal impact of the 100 Day Plan policies will be captured and managed against the Budget 2018 allowance.

Managing timing issue between agreement to the policies and the fiscal implications

We have recommended that the 13 November Cabinet paper should reflect the financial implications of the policy decisions in the following manner:

- Agreement to the upper bound of the estimated gross annual costings (\$225 million per annum) be charged against Labour's Fiscal Plan;
- Finalised costings will be submitted to Cabinet on 27 November for confirmation;
- Any adjustments required will be reflected at that point and Cabinet approval sought to detailed changes to appropriations.

This approach will provide interim financial authority to the policy decisions, and sufficient certainty for the calculation of the allowances in order to prepare fiscal strategy advice.

Policy Design Matters – Increasing Student Support

At the last Ministerial meeting, Ministers agreed to some broad design choices to deliver the Government's commitments. Ministers also sought further information on two issues to support decisions required to finalise the 13 November Cabinet paper. A report with this information has been forwarded to you from the Minister of Education. The two decisions are:

- 1) Should the income threshold for student allowances remain the same after \$50 increase?
- 2) Are you comfortable with proceeding with student allowance increases through base rate change, given the impacts on the benefit system?

IN-CONFIDENCE*Matters to consider with the income threshold for student allowances remaining the same after the \$50 increase*

- 1) Leaving student allowance income thresholds the same will mean more students can access more student allowance support. In particular, those on incomes that currently mean their allowance is abated to \$0 will, after the changes, receive \$50 from student allowances. Currently, agencies do not hold information on the likely number of new student allowance recipients.
- 2) There may be a small number of people for whom extra student support assistance results in less support from other sources – for example, supplementary income-tested assistance available through the benefit system, and Working for Families. Agencies are working to identify these impacts prior to lodgement of the Cabinet paper.

Matters to consider about alignment between the student support and benefit systems

- 1) The current net student allowance rate aligns with the equivalent Jobseeker Support and Sole Parent rates. There is a risk that increasing the student allowance may incentivise some people currently receiving benefits to enter study primarily for the purpose of receiving this additional support. In practice, we consider the lower rates of accommodation and other support available to students (even with the increase to the accommodation support of \$20 planned as part of the Families Package) significantly lowers this risk, except in the case of sole parents who receive the same accommodation support whether in study or receiving benefits.
- 2) There are also safeguards around provider and student performance which can help manage this risk and these settings can be refined and improved over time.

Note that even with mitigations, risks associated with these changes remain, and there will be increased costs if bringing the benefit system rates back into alignment with student support rates is desired in the future. In our feedback to the Ministry, we have suggested the Cabinet paper requests agencies to closely monitor the impact of the changes, and that the Minister of Social Development report back to Cabinet with an update later next year.

Policy Issues – Fees-free Tertiary Education

We understand that the Ministerial group will receive an initial briefing at the meeting on delivery channel options for fees-free education and training in 2018. Education officials will likely discuss the risks and trade-offs associated with each of the options. We will provide you with advice on the delivery channel options ahead of the next Ministerial group meeting.

IN-CONFIDENCE**Next Steps**

There are a number of decisions that will need to be made in the coming weeks to ensure that the 100 Day Plan tertiary education policies are implemented by 1 January 2018. The Treasury will provide you with advice ahead of these key decision points. Below is an indicative timeline of these:

- **Mon 13 Nov:** Cabinet paper seeking decisions on increasing student support policy and broad eligibility criteria for fees-free tertiary education
- **Wed 15 Nov:** Ministerial group meeting seeking decisions on delivery channel options for fees-free
- **Mon 20 Nov:** Fiscal strategy paper going to Cabinet to confirm fiscal strategy and allowances
- **Wed 22 Nov:** Ministerial group meeting seeking agreement on the second tertiary education Cabinet paper
- **Mon 27 Nov:** Cabinet paper seeking final decisions on fees-free and student support policies (including costings).

Heather Maletino, Analyst, Labour Market, Immigration and Tertiary Education,
s9(2)(k)

Andrew Rutledge, Acting Manager, Labour Market, Immigration and Tertiary
Education, s9(2)(k)

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Reference: T2017/2529

SH-4-6-4

Date: 15 November 2017

To: Minister of Finance (Hon Grant Robertson)
Associate Minister of Finance (Hon Dr David Clark)

Deadline: Before the Ministerial Group meeting 4:30PM, Wednesday 15 November

Aide Memoire: Cabinet paper seeking decisions to support making tertiary education and training affordable for all**Purpose**

You are due to have two discussions relating to the tertiary education changes outlined in the Government's 100 day plan.

- There is a Ministerial Group meeting at 4:30pm on Wednesday 15 November
- The Minister of Education has lodged Cabinet paper seeking final policy decisions on the \$50 per week increase to student loan living costs and allowances. This will be discussed at the Cabinet Business Committee (CBC) on Thursday 16 November.

This briefing supports both discussions, and includes advice on the relationship to Budget strategy and allowances, Treasury comment on the indicative policy costings sought through the Cabinet paper, and outlines the next steps in the process.

Ministerial Group Meeting

- While the preferred solution for the fees-free policy is a provider-based solution, this option will require provider buy-in. We are aware that some providers have raised concerns about how this option would work in practice and the administrative burdens it may place on them. The Ministry of Education has advised us they are also working on an alternative solution, where students would borrow fees which are then written-off once eligibility is determined (the student loan/Study Link option). Officials will discuss the details at this meeting.
- There are other design choices relating to the fees-free policy being considered in order to reduce the administrative burden associated with implementation. However, these carry potentially significant fiscal impacts. One example of this is whether the full fee of courses that extend beyond one EFTS in a single year

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would be covered by the policy (which might cost an additional \$25m per annum). We recommend setting the expectation with your colleagues that the costs associated with these design choices are made clear, and are considered relative to the cost of addressing the administrative burdens that are driving the design choices.

Cabinet Paper***Relationship to Budget Strategy and Allowances***

As part of the final policy decision on the \$50 per week increase to student loan living costs and allowances, this paper seeks agreement to the indicative costings. It recommends that they be managed against the operating and capital spending that will be reflected in the Half-Year Economic and Fiscal Update (HYEFU).

The indicative costings, alongside other costings of individual policies in the 100 Day Plan, will be used to inform the Budget allowances and the Budget Strategy. Following this, finalised costings for these policies will be submitted for Cabinet approval on 27 November. Any adjustments to funding required will be reflected at that point and Cabinet approval sought to detailed changes to appropriations.

Policy Costings

The Ministry of Education is responsible for policy costings as part of its core departmental role. The Treasury has been engaging with the Ministry on the development of costings. Our initial assessment is that the approach taken to the costings is robust (relative to the timeframes allowed) and we will be working to provide the appropriate level of quality assurance before finalised costings are submitted for Cabinet for approval on 27 November.

One concern we have with the current approach to costing the policies is that the costing for the \$50 increases is based on projected 2018 student numbers whereas the costing for the fees-free policy is based on 2016 student numbers. We do not believe there is a sound rationale for costing the two policies using different student numbers, and will be working with the Ministry to ensure the finalised costings use a consistent methodology.

Fees-free Policy

The Ministry of Education is continuing to progress the policy costings for the fees-free policy but are not yet in a position to present indicative costings to Cabinet. As a result, for Cabinet agreement to the Budget Strategy and allowances on 20 November, the costings from the Fiscal Plan will be used, unless indicative costings become available before then. If the finalised costings in the 27 November Cabinet paper exceed what was originally allocated in the Fiscal Plan, this will need to be managed against the Budget 2018 allowance.

IN-CONFIDENCE*Increases to Student Support Policy*

These costings have progressed from what was provided to you in the draft Cabinet paper last week. Two key changes have been made:

- *5% increased uptake:* we have recommended that the Ministry applies a 5% increase over baseline volumes from 2019/20 onwards to reflect increased uptake driven by the policies around increases to student support and the introduction of fees-free study. This is only indicative, and is included to manage the risk that the finalised costings exceed the ones on which Cabinet bases its decision.
- *Treatment of impacts:* as the date for the Government's net debt target is before the typical repayment time of loans (7 years), the full impact of the loans (capital lending) will impact the net debt target. Therefore the capital lending is reflected in the financial recommendations. This approach reflects the decision that costs associated with the 100 Day Plan are being managed against achieving the Budget Responsibility Rule of reducing net debt to 20% of GDP by 2021/22.

As a result of the above changes, the indicative costs now exceed what was originally allocated in the Fiscal Plan for increasing student support. Additionally, these costs do not include any other changes through the "Additional Student Financial Support" line in the Fiscal Plan that are not included in the 100 Day Plan, such as restoring post-graduate students' eligibility for student allowances. If the finalised costings in the 27 November Cabinet paper exceed these indicative costs, this will need to be managed within the Budget 2018 allowance.

(\$millions)	2017/18	2018/19	2019/20	2020/21	2021/22
Indicative costings	94	200	305	309	316
Fiscal Plan	139	273	274	275	275
Difference	-45	-73	31	34	41

Despite the inclusion of the assumption of a 5% increase in later years, there are fiscal risks associated with this policy that are unable to be fully quantified at this point:

- *Impact of behaviour change on demand:* Although we expect the impact to be limited during the first two years of implementation, there is no precedent for such a significant increase in rates of living support, and the change related to fees-free is also unprecedented and may change uptake. If the finalised costings included in the 27 November Cabinet paper (which will include a forecast of likely behavioural response) exceed the indicative costings outlined in this Cabinet paper, agreement to additional funding will be required.
- *Impact on the student loan write-down (which impacts on OBEGAL):* We have reviewed the methodology the Ministry of Education has used to calculate the write-down ratio (46.55 cents in the dollar) for student loans. We are comfortable

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with their approach, but this ratio would change if students alter how fast they repay their loans. This cannot be predicted, and the costings are very sensitive to this assumption. We have been advised by the Ministry that a one cent change in the assumed 46.55 cent write-down value would change the valuation of the write-down by approximately \$1 million.

Next Steps

There are a number of decisions that will need to be made in the coming weeks to ensure that the tertiary education changes outlined in the 100 Day Plan are implemented by 1 January 2018. The Treasury will provide you with advice ahead of these key decision points.

- **Mon 20 Nov:** paper seeking final policy decisions on the \$50 weekly increase to student loan living costs and allowances, as well as the Budget strategy paper confirming Budget strategy and allowances, are discussed at Cabinet.
- **Wed 22 Nov:** Ministerial group meeting seeking agreement on the second tertiary education Cabinet paper.
- **Mon 27 Nov:** Cabinet discussion of paper seeking final decisions on fees-free and student support policies (including finalised costings).

Harry Nicholls, Analyst, Education and Skills, s9(2)(k)

Andrew Rutledge, Acting Manager, Labour Market Immigration and Tertiary Education, s9(2)(k)

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Reference: T2017/2546 SH-4-6-4

Date: 16 November 2017

To: Minister of Finance (Hon Grant Robertson)
Associate Minister of Finance (Hon Dr David Clark)

Deadline: Before Pre-Cabinet meeting on Monday 20 November
(if any)

Aide Memoire: Fiscal implications of tertiary education changes

Purpose

This note provides an update on the fiscal implications of the tertiary education policy changes, to give you visibility of rising costs and potential points of discussion for the Ministerial sub-group meeting at 4:30 pm on Monday 20 November. We would like to discuss the matters raised in this note with you at the Pre-Cabinet meeting on Monday morning.

Summary

The costs of the fees-free policy are rising above the levels initially advised in the indicative costings provided on 30 October, due to both updated information and policy decisions. We are not yet clear whether the costs of the policy will exceed those outlined in the Fiscal Plan (which have been reflected in HYEPU and are informing the Budget Strategy discussion at Cabinet on 20 November). However, the indications are that the costs are getting close to what is currently allocated and are going to be significantly above those previously provided to Ministers. We understand that updated costings of the fees-free policy will be provided to Ministers with a draft Cabinet paper tomorrow.

Matters of note regarding the fiscal implications

Fees-free policy

The Ministry of Education provided Ministers with indicative costings of the fees-free policy on 30 October. With the estimated savings from the write down on student loan lending (as a result of reduced borrowing for course fees), these gave the policy a net cost of \$214 million per annum, below what is allocated for the changes in HYEPU (\$344 million in the first full year of implementation).

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Un-capped EFTS is assumed in indicative costings, but the fiscal impact is significant

The indicative costings did not include a cap on the amount of EFTS the fees-free policy would cover. 1 EFTS typically represents one year of study, but approximately 18% of students study more than 1 EFTS in a year. This is in line with the latest advice Ministers have received from officials, namely that it would be preferable to not include any cap on EFTS in the first year of implementation due to administrative complexity. However the fiscal cost is significant – the Ministry of Education has estimated that increasing the cap from 1 EFTS to 1.2 EFTS costs approximately \$25m per annum. (and this does not include the further marginal cost of the 4% of students who study more than 1.2 EFTS).

Policy design choices with fiscal impacts

There are a number of policy design choices currently being considered by Ministers which were not included in the indicative costings and carry fiscal implications:

- **Industry training is not included.** Ministers have confirmed that the fees-free policy applies to industry training. However, the indicative costings did not include students taking part in industry training. The Ministry of Education estimates this will add **approximately \$25m per annum.**
- **Student services fees are not included.** Ministers have agreed in principle to including compulsory student services fees in the fees free policy. The Ministry of Education estimates this will add between **\$21-24m per annum.**
- **Prior study limits.** The indicative costings only included students with no previous study at a tertiary provider. Including students who have participated in up to 0.5EFTs of previous study at a tertiary provider will add **approximately \$40m per annum.**

The Ministry has only approximated these costs at this point but it is worth noting that they collectively sum to just under an additional \$90m per annum.

Increases in student demand will have fiscal implications

The indicative costings included only a low assumption of increased student demand (2.5% increase over what is currently forecast for 2018). While we expect a limited increase in demand in the first years there is likely to be substantive increases in subsequent years with associated fiscal impacts.

\$50 per week increase to student loan living costs and allowances

The Ministry has developed indicative costings for this policy which were considered at CBC on 16 November. These are currently \$12 million below what is allocated in the Fiscal Plan over the forecast period, but exceed the Fiscal Plan annually (and over the forecast period) from 2019/2020 onwards.

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(\$millions)	2017/18	2018/19	2019/20	2020/21	2021/22	Total
Indicative costings	94	200	305	309	316	1224
Fiscal Plan	139	273	274	275	275	1236
Difference	-45	-73	31	34	41	12

The indicative costings for the first two years do not factor in any increased demand driven by either the increases to student support or the introduction of fees-free study. In the subsequent years, a 5% increase over baseline volumes has been applied to reflect likely increased demand. This 5% is likely an overestimate of increased demand, and is in part offset by no estimate of increased demand in the first two years. Finalised costings refining these estimates will be provided to Ministers through the 27 November Cabinet paper.

Even with finalised costings however, there are fiscal risks associated with the impact of behaviour change on demand and the impact of the student loan write-down, which are unable to be fully quantified at this point.

Points of discussion for the Ministerial sub-group meeting

In light of the fiscal implications outlined in this note you may wish to raise the following matters at the Ministerial sub-group meeting on Monday 20 November:

- **Decision on the EFTS cap:** How can Ministers be provided with more detailed advice on the administrative costs associated with implementing an EFTS cap in order to make an informed decision? At the previous Ministerial meeting on 8 November you asked for further advice on the administrative costs of implementing a cap at 1 EFTS so that Ministers could consider those costs relative to the cost (in tuition fees etc.) of approx. \$25m plus per annum of having no cap in place. This information was not provided to Ministers at the 15 November meeting, though an on the spot estimate of \$5m was given.
- **A Cabinet report back in first half of 2018:** Implementing the fees-free policy for the beginning of 2018 is a difficult task on tight timeframes. The implementation option for 2018 is an interim solution, with a longer-term solution to be determined by 2019. It may be worthwhile, however, to suggest a report back to Cabinet in the first half of next year to update Ministers on behavioural and fiscal impacts of the interim solution, and with a focus on any further work or changes required to manage the fiscal risk associated with an unlimited EFTS approach (if that is the decision taken by Ministers).
- **Fees-free policy costings:** The Ministry is moving at pace to undertake policy costings for both the student allowance and fees-free costings. These are complicated exercises. We think it would be worth requesting Ministry officials talk Ministers through their latest costings at the meeting on Monday, with a particular focus on any assumptions that Ministers should be aware of, and what the likelihood is that the actual cost might exceed their estimate.

IN-CONFIDENCE**Next steps**

17 November: Ministry of Education provide Minister of Education with draft Cabinet and updated fees-free policy costings.

17 November: Treasury begin reviewing updated costings in order to provide you with further advice on the fiscal implications.

20 November: Pre-Cabinet meeting with Treasury officials to discuss this note and updated costings with you.

20 November: Budget Strategy discussion at Cabinet.

20 November: Regular Ministerial sub-group meeting on tertiary education policy changes at 4:30pm.

21-23 November: Fees-free Cabinet paper expected to be lodged.

Harry Nicholls, Analyst, Education and Skills, s9(2)(k)

Andrew Rutledge, Acting Manager, Labour Market, Immigration, and Tertiary Education, s9(2)(k)

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**Treasury Report: Final Decisions on Tertiary Education Changes**

Date:	24 November 2017	Report No:	T2017/2588
		File Number:	SH-4-6-4

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	<p>Note the updated costings and fiscal implications of the tertiary education policy changes</p> <p>Note we have provided a Treasury Comment in the Minister of Education's paper being considered at Cabinet on 27 November</p>	Monday 27 November 2017

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Harry Nicholls	Analyst, Labour Market, Immigration and Tertiary Education	s9(2)(k) (wk)	N/A (mob)
Andrew Rutledge	Acting Manager, Labour Market, Immigration and Tertiary Education	s9(2)(k) (wk)	N/A (mob) ✓

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

IN-CONFIDENCE**Treasury Report: Final Decisions on Tertiary Education Changes**

Executive Summary

This report provides an update on decisions sought through the Minister of Education's Cabinet paper, "Making tertiary education more affordable: fees-free education in 2018", scheduled for discussion at Cabinet on Monday 27 November.

The Cabinet paper includes the final costings for both the student loan living costs and allowances changes, and the implementation of a first year of fees free study from 1 January 2018.

The final costings for the first year of fees free study are higher than the draft costings the Ministry of Education provided to the Ministerial Group on 20 November. The indicative costings for student loan living costs and allowances changes and the Fiscal Plan costings for fees-free study were used in the Budget Strategy Cabinet paper and fiscal strategy advice to calculate the Budget allowances. The final costings have the following impacts:

- Operating expenditure is \$745 million higher over the forecast period resulting in an impact on the Operating Balance before Gains and Losses (OBEGAL), and
- Reduced capital expenditure over the forecast period resulting in a positive net debt impact of \$365 million.

For the avoidance of doubt, there is no additional charge against Budget 18 allowances and the costs of these policies is factored into the Half Year Economic and Fiscal Update (HYEFU).

While final costings are provided, the relevant appropriation changes have not been included in the Cabinet paper. Interim financial authority is sought for Joint Ministers to approve the appropriation changes within the range of the final costings.

We have included a Treasury Comment in the Cabinet paper highlighting that the final appropriation changes not being included with the final costings is unusual. We consider that the approach of seeking interim financial authority is appropriate in this instance due to the timeframes required for these policies to be implemented by 1 January 2018.

Treasury has reviewed the methodology and assumptions used by the Ministry of Education in the costings and we believe they are appropriate. However, the fees free policy in particular is a major change, and it is difficult to predict what behavioural changes will result from it, especially the impact on demand after 2018.

As officials have previously advised, there is some risk around the interim provider-based solution used for the delivery of fees-free study in 2018. The Cabinet paper includes our suggestion of a series of report backs to Ministers as a way of managing risks by identifying and addressing issues early.

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Recommended Action

We recommend that you:

- a **note** the Cabinet paper lodged by the Minister of Education has final policy costings for both the student loan living costs and allowances changes, and the implementation of a first year of fees free study from 1 January 2018, and that these costings are higher than those Ministry of Education officials advised at the Ministerial Group meeting on 20 November
- b **note** compared to the estimated costs included in the Budget Strategy Cabinet paper, the operating expenditure is \$745 million higher over the forecast period, while capital expenditure is \$1,100 million lower over the forecast period
- c **note** that this results in the following additional impacts over the forecast period:
 - a. Increased operating expenditure of \$745 million, and
 - b. A positive net debt impact of \$365 million.
- d **note** if the fees-free policy is later extended to additional years of fees-free study, further costs will need to be managed against future Budget allowances.
- e **note** that while Cabinet have been provided with the final costings for the tertiary education changes, it is difficult to predict what behavioural changes will result from it, especially the impact on demand after 2018
- f **note** Treasury has engaged with the Ministry of Education to review the methodology and assumptions used to develop the costings, but has not provided a full audit of the underlying calculations.
- g **note** we have provided a Treasury Comment highlighting that the final appropriation changes not being included with the final costings is unusual. We consider the approach of seeking interim financial authority with Joint Ministers appropriate in this instance due to the timeframes required for these policies to be implemented by 1 January 2018.
- h **note** the provider-based solution for delivering the fees-free policy in 2018, and the risk and mitigation associated with this.
- i **note** the timetable for report backs to Ministers in 2018, to identify any implementation issues and behavioural changes, and provide options for the long-term administration of fees-free study.

Andrew Rutledge
**Acting Manager, Labour Market,
Immigration and Tertiary Education**

Hon Grant Robertson
Minister of Finance

IN-CONFIDENCE**Treasury Report: Final Decisions on Tertiary Education Changes**

Purpose of Report

1. This report provides an update on decisions sought through the Minister of Education's Cabinet paper, "Making tertiary education more affordable: fees-free education in 2018", scheduled for discussion at Cabinet on Monday 27 November. Specifically it covers a number of issues related to the tertiary education changes developed as part of the Government's 100 Day Plan, including:
 - Process of approving final appropriations
 - Final policy costings
 - Fiscal implications of the policy changes
 - Use of an interim solution for delivery of fees free study in 2018
 - The process for monitoring outcomes over 2018
 - Options for the long term administration of fees free study

Process for Approving Final Appropriations

2. This Cabinet paper presents final costings for both the student support and the introduction of a first year of fees free tertiary education study outlined in the 100 Day Plan. These include the costs of the policy changes themselves, as well as an assumption of additional costs due to increased demand.
3. However, despite including the final costings for Cabinet approval, the final appropriations are not included. This is a result of the need to secure timely Cabinet decisions on the policy to ensure implementation by 1 January 2018 and officials' need for slightly more time to finalise the appropriations. In this case, we support the approach of seeking interim financial authority with joint Ministers subsequently approving appropriations within the range of the final costings.
4. We have included a comment in the paper noting that final appropriations not being included in the paper is unusual, and signalling that Cabinet should expect when it is making policy decisions on proposals of this magnitude in the future, and outside of these particular circumstances, that papers will include the full financial implications.

Final Policy Costings

5. The final costings for both policies are below the estimates that were used in the Budget Strategy Cabinet paper to calculate the Budget allowances, so no additional expenditure will need be to be managed against allowances.
6. However, the final costings for the first year of fees free study are higher than the draft costings the Ministry of Education provided to the Ministerial Group on 20 November. It appears most of the discrepancy is due to the savings from the reduction in student loan lending being significantly lower than previously calculated. We have asked the

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Ministry of Education to provide an explanation for this discrepancy, and can provide you further advice as necessary once we have received this.

7. If the policy is later extended to additional years of fees free study (e.g. the second year of fees-free signalled for introduction in 2021), these further costs will need to be managed against future Budget allowances.

Treasury's role

8. Policy costings are part of the core role of departments. Treasury has met with the Ministry of Education to review the methodology and assumptions used to develop the costings, but has not provided a full audit of the underlying calculations. While we are comfortable with the methodology and assumptions used, the fees free policy in particular is a major change, and it is difficult to predict what behavioural changes will result from it, especially the impact on demand from 2018.

Demand impacts

9. The Ministry of Education had previously forecast EFTS funded at qualification level three and above would decline by 4.0% between 2016 and 2021, as a result of demographic changes and labour market factors (i.e. declining unemployment).
10. To allow for the impact of behavioural changes resulting from both policies, the costings include the following assumptions around increased demand:

Table A

	2017	2018	2019	2020	2021	2022
EFTS	205,960	205,960	205,960	208,020	211,110	211,110
Percentage change compared to 2017		0.0%	0.0%	1.0%	2.5%	2.5%
Increase compared to forecast EFTS		0.8%	2.0%	3.8%	5.6%	5.1%

Student loan living costs and allowances

11. The changes Cabinet agreed to on 20 November include:
 - a net increase for student allowance base rates of \$50 per week, per adult, based on an M tax code (note that this will mean a \$100 increase for couple rates that reflect the living costs of two adults in a relationship)
 - a \$50 per week increase to the Student Loan Scheme living costs maximum.
12. The indicative costings agreed to by Cabinet included an assumption of no increased demand in the first two years of implementation, with a 5% increase from 2020/21 through to out years. The final costings include the refined assumption of demand outlined in Table A. With the refined assumption of demand, the final costings are under what was included in the Fiscal Plan and the indicative costings (which were included in the Budget Strategy and allowances).

IN-CONFIDENCE***Fees-free study***

13. The Cabinet paper includes both the final policy decisions for the implementation of a first year of fees-free study in 2018, as well as finalised costings. We have previously provided you with advice on how the final policy decisions around prior study limits and the treatment of part-time study impact on the costings [T2017/2546 refers].
14. Through our engagement with the Ministry we have sought to clarify several aspects of the costings and note that there are some of areas of significant uncertainty, in particular:
 - ***The Student Loan write-down expense:*** While the value of loans avoided can be relatively precisely estimated, the ratio for the write-down (which reflects the time value of this money) is more difficult. Due to lower student loan lending, the write down expense will be lower. We believe the Ministry has made the best possible estimate but they have advised us in discussions that each percentage point increase in the rate would roughly reduce the fiscal impact by \$1 million p.a. The write-down ratio will be reviewed by PwC in January 2018 as part of the normal valuation process around the Student Loan portfolio.
 - ***The Student loan interest unwind revenue:*** Due to the lower lending, the Government will no longer recognise the interest unwind revenue (which reflects the reversal of the day one write down over time). This is also difficult to accurately predict.
 - ***The industry training numbers.*** Because of the different policy and regulatory settings in this area, the Ministry has less data on the amount currently paid in fees, however, any reasonable variance is likely to have only a minor impact on the final numbers.

Fiscal Implications of the Policy Changes

What were the costs for allowances?

15. Total operating expenditure of \$2,101 million and capital expenditure of \$696 million over the forecast period were used in the Budget Strategy Cabinet paper and fiscal strategy advice to calculate the Budget allowances [CAB-17-MIN-0506 refers].
16. These estimates of operating and capital expenditure had a \$2,797 million impact on net debt over the forecast period and have been factored into the preliminary fiscal forecasts for the Half Year Economic and Fiscal Update (HYEFU).

What's happened and why

17. The updated costs received on 23 November now show operating expenditure of \$2,846 million and a *reduction* in capital expenditure of \$404 million over the forecast period. Compared to the costs estimates from 20 November, the operating expenditure is \$745 million higher over the forecast period, while capital expenditure is \$1,100 million lower over the forecast period.
18. As a result we recommend that the:
 - Increased operating expenditure of \$745 million be managed against the Operating Balance before Gains and Losses (OBEGAL), and
 - Because the cash expenditure is fully offset by the reduction in capital expenditure over the forecast period, which results in a positive net debt impact of \$365 million, that this be flowed through HYEFU as well.

IN-CONFIDENCE

\$000s	Operating expenditure	Capital expenditure	Net debt
Costings used to calculate Budget allowances	\$2,101	\$696	\$2,797
Final costings	\$2,846	-\$404	\$2,442
Variance	\$745	\$1,100	\$365

19. The paper seeks approval to manage the impacts in paragraph 18 above against the fiscal indicators rather than adjusting the Budget 2018 operating and capital allowances. The rationale for this is that the additional operating expenditure is offset by the reduction in capital expenditure over the forecast period, which results in an overall positive impact on net debt.

Use of an Interim Delivery Solution for Fees-Free Study

20. The paper seeks approval to implement an interim provider-based solution to meet the goal of implementing a first year of fees free study in 2018. In this model students' eligibility for fees-free is determined at the time of enrolment, and providers charge the Tertiary Education Commission (TEC), rather than students, for fees covered by the policy.
21. On balance, we think that the provider-based approach provides the best interim solution and provides a logical bridge to a longer term solution. The alternative approach using the Student Loan Scheme would involve additional regulatory, accounting, and operational complexities.
22. The key risk of the provider-based approach is misbehaviour from providers and students, where fees-free study is charged to the government for ineligible students (we only have information of previous study from 2003 onwards). However, the TEC has audit and financial functions that would help to mitigate this risk at the provider level.
23. TEC will be working closely with providers to support them to implement this interim solution.

Process for Monitoring Outcomes Over 2018

24. Since this policy has uncertainty both around implementation and behavioural changes, we have suggested a series of report backs as a way of managing the risks by identifying and addressing issues early. Past experience with the tertiary education sector suggests that this sector is highly reactive to policy changes, but that these reactions are not always predictable. Therefore, although two of the scheduled reports are to the Minister of Education, we recommend you are involved in the ongoing monitoring.
- **A report to the Minister of Education, following the February-March enrolment peak.** By this stage any implementation issues will be clear, and there may be informal information about the behavioural responses of students and institutions.

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- **A report to Cabinet following analysis of initial 2018 data in June.** By this stage the enrolments for the second semester will be known, so that any unintended consequences on the behaviour of either institutions or students can be considered for the design of the long term administration of fees free study.
- **A report to the Minister of Education by late October.** By this stage the final design parameters for the long term administration of this policy will be known, and this review could inform any final decisions.

Design for the Long Term Administration of Fees-Free Study

25. The design for long-term administration of the fees free policy might not deviate substantially from the interim delivery mechanism. Examples of the issues that will need to be resolved for both provider-based and industry training include how funding is delivered (e.g, it could potentially be included in the existing tuition subsidies, removing the administrative burden of running multiple systems), and what systems need to be in place in order to improve both the timeliness and accuracy of determining eligibility (at present providers only return student data to the Ministry and the TEC quarterly).
26. Resolving these issues may require further investment, so while the final design parameters should be known by late October, we recommend you make it clear to officials the extent to which initial advice should be presented as part of the report to the Cabinet following analysis of initial 2018 data in June. We consider that an early identification in the first half of next year of options for the design is sufficient time to ensure a long-term solution is in place for 2019.

Next Steps

- **27 November:** Following Cabinet approval of the proposed changes, TEC will lead on the implementation of the fees free changes for 2018.
- **Mid-December:** Final appropriations will be presented to Joint Ministers to approve.
- **1 January 2018:** Implementation of the student loan living costs and allowances changes, and the first year of fees free study.