Unpaid student loans 'a fiscal time bomb for universities'

Commons committee chairman Adrian Bailey speaks out after government revises down number of loans that will be repaid

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Adrian Bailey says the Treasury needs to face up to the student loan repayment problem. Photograph: David Levene

The university sector is facing a "fiscal time bomb", the chairman of the Commons business committee has warned, after it was revealed that the government has dramatically revised down the proportion of student debt that will ever be repaid.

Adrian Bailey said the Treasury needed to face up to the problem, after David Willetts, the universities minister, revealed the rate of non-repayment of student loans is near the point at which experts believe tripling tuition fees will add nothing to Treasury coffers.

Bailey said: "There is a huge potential black hole in the government's budget figures. You've got all these confident predications about budget deficit falling and right in the middle of that is a potential fiscal time bomb that doesn't seem to have been addressed."

Bailey said his committee would next month consider recalling Willetts to explain himself over the rising student-default estimates.

The Guardian revealed on Friday that the proportion of graduates failing to pay back student loans is increasing at such a rate that the Treasury is approaching the point at which it will get zero financial reward from the government's policy of tripling tuition fees to £9,000 a year.

New official forecasts suggest write-off costs have reached 45% of the £10bn in student loans made each year, all but nullifying any savings to the public purse made following the introduction of the new fee system.

Willetts, in response to a parliamentary question from the shadow education minister, Liam Byrne, confirmed that the write-off figure – the resource accounting and budgeting (RAB) charge – was rapidly approaching the 48.6% mark. This is the threshold at which experts calculate that the government will lose more money than it would have saved by keeping the old £3,000 tuition fee system.

The coalition's decision to introduce higher fees shortly after it formed led to rioting and forced a dramatic decline in the Liberal Democrats' poll ratings, from which the party has never fully recovered.

Lower pay for young adults, an over-supply of those with degrees and the worsening economic outlook have all contributed to the revised civil service forecasts, which conclude that far fewer graduates will earn enough to repay loans over their working lives. Four months ago, Willetts notified parliament that the rate had risen to 40% from 35%. In 2010 the estimate was 28%.

The hasty revision of departmental forecasts means that by 2042, about £90bn out of the overall £200bn in student loans will remain unpaid. The response to the parliamentary question said: "This department has been reviewing our modelling of the RAB charge on student loans. We currently estimate the RAB charge on student loans to be around 45%, which reflects our current estimate of the costs to government of the higher education subsidy to students.

"By its nature an estimate is subject to change as it is highly dependent on macroeconomic circumstances, and the growth of graduate earnings over the next 30 years.

"We will continue to review our estimates in line with the latest data and advice from experts and stakeholders."

This week, London Economics found that if the write-off of students' loans increased beyond 48.6%, "the economic cost of the 2012-13 higher education reforms will exceed the 2010-11 system that it replaced". The 45% RAB figure covers the write-off expense of both old and new-style student loans.

The National Union of Students higher education vice-president, Rachel Wenstone, said the figures represented a turning point in the debate over student funding.

"These revelations blow apart ministers' claims that £9,000 fees would save public money. This confirms our long-held view that the changes were ideologically driven. The government's system costs more than what it replaced and represents a real turning point in the debate about the future of higher education funding.

"Forcing debt on to students as a way of funding universities is an experiment that has well and truly failed. We need a new deal for higher education funding for the next generation of students."

Pam Tatlow, the chief executive of the university thinktank million+, said costs were "likely to increase further and raise real questions about whether the upheaval caused by the new system has been worth it".

Figures buried in this week's budget forecasts also reveal that receipts from student loans are likely to be £2.5bn lower than expected over six years, compared with estimates from the December autumn statement. The Office for Budget Responsibility (OBR) said lower earnings estimates have "reduced our forecast for aggregate repayments".

The economics watchdog added: "As a consequence, we now expect greater write-offs beyond our medium-term forecast horizon, and will update the longer-term projections in our next fiscal sustainability report, to be published in July." Speaking in the House of Commons on Thursday, Bailey, the Labour MP for West Bromwich, demanded more answers from the government about what it could do to make up the shortfall.

"It is estimated that if [the default rates] reach 47%, the cost of the current student-funded scheme will outweigh the old system. We are already at about 40% to 42%, and the latest predictions indicate that it will reach the threshold very shortly. That is acknowledged by the OBR, although there is no acknowledgment of how this will be funded.

"I believe that there is a huge potential hole in the government's budget predictions, because they are locked into a financial funding model for higher education that is increasingly becoming unfunded.

"Furthermore, they have grafted on to it a welcome commitment to funding extra places, but on the basis of a model that does not appear to be viable and a funding regime that looks unlikely to realise the necessary amount of money."