Introduction

Chapter 1: The Case for Introducing Student Loans

Throughout the world, education systems are facing increasing financial constraints. Some governments are opting to reduce public expenditure as a vital element in their long-term economic strategies. Others are being forced to reduce spending by medium or short term factors, particularly the world recession and the collapse of the price of oil and other primary products, which has caused a sharp fall in revenue in many countries.

The pressure of increasing demand for education, however, continues unabated. Some of this is due to demographic trends, particularly in developing countries, where the growth in school and college age population is substantial. Equally important is the rising private demand for education. As more and more young people and their parents see secondary or higher education as the key to secure, well-paid jobs in the modern sector, an increasing proportion of the age group aspires to higher education. Evidence on the social and private returns to education suggests that education is still a profitable investment both for individual students and for society as a whole. But government budgets face severe financial constraints. Public expenditure on education already absorbs 15 to 20 per cent of total government expenditure in many developing countries, and cannot keep pace with rising demand for more or better quality education.

Financial Constraints Confronting Higher Education

In many developing countries governments are particularly concerned to reduce the costs of higher education. Costs per

student in universities and colleges are high in relation to other levels of education. In developed countries on the whole, one university student costs the government as much per year as three or four primary school pupils. But in Asia one student in higher education costs as much as ten or fifteen primary school pupils per year. In many African countries a whole class of thirty or forty children could receive a year's schooling for the annual cost of a single student at the university level, and in some developing countries one university student costs more than 100 primary school pupils.

There are many reasons why higher education is so costly in relation to lower levels of education in developing countries. Low student-teacher ratios and the small size of some universities or colleges means that economies of scale cannot be exploited; the costs of equipment, particularly for science or engineering, are high, as are the costs of libraries and other specialized facilities. In some countries the need to recruit expatriate teachers to overcome domestic shortages of highly skilled manpower and the need to import books, materials or equipment from overseas both push up costs. Another cause of high costs is the fact that universities are often modelled on the residential campus common in Europe or North America.

The share of higher education costs borne by the government is often very high. Many countries do not charge tuition fees for higher education, or, if fees are charged, they are fixed so low that the extent of cost recovery is minimal. Not only do students pay very low fees, but in many developing countries students also receive free board and lodging, and even 'pocket money' in some cases.

The cost of scholarships and bursaries for living expenses is sometimes dramatic: in some parts of Africa, for example Burkina Faso, Cameroon, or the Ivory Coast, students' living allowances represent over 40 per cent of the entire government budget for higher education.

A New Look at Patterns of Subsidising Higher Education

Many economists have questioned whether such high subsidies are either efficient or equitable. Governments subsidise higher

education for many reasons. Social and political pressures are important, as well as economic justifications, which include:

* ensuring an adequate supply of skilled manpower for the economy,
* preventing underinvestment in education, since the social benefits of having a skilled and adaptable labour force exceed the private financial benefits to the individual,
* providing equality of opportunity for all citizens, regardless of wealth, to ensure that students from low-income families are not prevented from participating in higher education by inability to pay fees or finance living expenses.

In many cases the decision to provide free university education, and to give scholarships, bursaries or grants towards students' living expenses dates from a period when newly independent countries faced serious shortages of skilled and professional manpower. The need to overcome these shortages in order to achieve economic growth and replace expatriates by trained nationals meant that rapid expansion of higher education was given top priority. It was considered imperative that no talented student should be discouraged from pursuing higher education because of inability to pay tuition fees or maintenance costs.

A policy of free tuition and generous scholarships was also justified on grounds of equity. The desire for social justice and equality of opportunity made it vitally important that the new colleges and universities being built should not recruit exclusively from among wealthy families who could afford to pay fees and support their sons or daughters during many years of study.

More recently it has been argued that the twin goals of efficiency and equity are not well served by these policies, which result in very high levels of subsidy for higher education. If judged purely by the criteria of cost-benefit analysis, this may not be the best use of scarce public funds. Evidence suggests that in many developing countries, expenditure on basic education at the primary level is more profitable, and offers a higher rate of return than education at the university level (Psacharopoulos 1985). Shortages of skilled manpower which gave rise to high levels of subsidy in the first place

have in many cases given way to surpluses and graduate unemployment.

There is also evidence that despite low or non-existent tuition fees, and generous scholarships and bursaries, it is still the children of the wealthy who are most likely to gain access to higher education and to be the chief beneficiaries of higher education subsidies. Low income pupils are often deterred from continuing secondary education, and so cannot gain the school-leaving qualifications necessary for university entry, and students from upper income families are more likely to attend high quality secondary schools or can afford to pay for private tuition to supplement low quality schooling. For a variety of reasons it is the rich, rather than the poor, who are most likely to benefit from highly subsidised universities and colleges of higher education.

Several governments have therefore proposed to move towards greater cost recovery in higher education, by introducing or increasing fees, while at the same time providing financial support for students to ensure that fees do not deter talented students from low income families. Policies of cost recovery may mean introducing or raising tuition fees or, in countries where students have traditionally enjoyed free lodging, the introduction of realistic charges for meals and accommodation.

Recently, such proposals have been given added impetus, not only by the growing financial constraints facing many governments, but also by the recommendations of the World Bank. A number of recent publications of the World Bank (for example, Psacharopoulos and Woodhall 1985) have argued for a shift in the balance between private and public funding for higher education, on the grounds that present policies of subsidising higher education mean that too much is spent on higher education in relation to lower levels, that present patterns of subsidy are inequitable since the children of 'white collar' workers and professionals enjoy a far greater share of public resources for education than the children of manual workers or farmers and agricultural workers, and it is the children of relatively wealthy families who are most likely to benefit from higher education.

The World Bank's recent paper on financing education (1986) has come down strongly in favour of a strategy of cost recovery involving:

* introducing or raising tuition fees in higher education
* charging students for board and lodging
* replacing scholarships and bursaries by student loans
* reallocating the revenue generated by these changes, in order to expand or improve the quality of primary education.

There are many politicians who remain unconvinced by such arguments, and who recognise all too clearly the difficulties of reducing subsidies which favour one of the most articulate and vocal groups in society.

Nevertheless, financial constraints are causing governments in many countries to reassess and modify their policies of financing higher education. In some cases this represents part of a strategy of shifting more of the financial burden of higher education from the taxpayer to those who will directly benefit from better employment opportunities and higher lifetime earnings. In other cases it is due simply to a desire to seek new sources of finance, in order to allow expansion for improvements in the quality of education.

One of the options being considered in several countries is the introduction of student loans, either to replace scholarships or bursaries, or to enable students to pay higher tuition fees or charges for accommodation. Some countries which already have loan programmes are considering expanding their existing schemes, in order to soften the impact of fee increases. Some governments see students loans as a way of expanding higher education without imposing excessive financial burdens on the public exchequer. For a variety of reasons, therefore, a number of governments have recently re-examined the case for student loans, and have turned to international experience for guidance.

International Experience with Student Loans

Student loans are already widely used as a means of financing higher education in both developed and developing countries. Government sponsored or guaranteed student loan programmes now exist in well over thirty countries, to enable students to borrow to finance tuition fees or living expenses. There is even one example of student loans in a Communist country: China has recently announced that in future only very low income students will receive

stipends. The remainder will receive loans. Some countries also have a number of private loan programmes, set up by religious or charitable organisations or by private universities.

There is nothing new in the idea of students borrowing money to finance education or training. Informal arrangements have always existed whereby young men or women financed their higher education by borrowing from a wealthy patron or relative in the expectation that high earnings in the future would enable them to repay the loan. Students in many countries borrow from relatives or friends, and even in the poorest countries the extended family will try to find money to finance one child's education, in the expectation that he or she will later finance schooling or higher education for younger relatives.

A fortunate few may therefore have access to informal loans, to enable them to invest in education to enhance their future earning capacity. For the vast majority, however, the only possibility of borrowing, except at very high rates of interest, is a scheme by which the government or banks provide educational loans on favourable terms. The reasons are simple: students need loans for a relatively long period, and the possibility of unemployment, illness or death means that there is a high degree of risk for the lender unless the loan is backed by some firm guarantee.

Banks are usually willing to provide commercial loans only to borrowers who can demonstrate their ability to repay the loan by assigning to the bank an asset, such as the deeds of property or land, or an insurance policy, which represent 'collateral', that is security for the bank that the loan will be repaid or, in the event of default, the asset can be sold. Since students rarely have assets which can be offered in this way, commercial banks may require a personal guarantee from a parent or relative who undertakes to repay the loan if the student defaults.

Governments in many countries have therefore established loan programmes, either financed from public funds, or backed by a government guarantee. The first official loan programmes — as opposed to private charitable or philanthropic ventures — were set up in Denmark, Sweden, the USA and Colombia in the 1950's. These were followed by an increasing number of government sponsored or guaranteed loan programmes for students in higher education, in the 1960's and 70's.

International experience shows that loans are feasible. Goverment-financed loan programmes are working in many developed and developing countries (Woodhall 1983). Nevertheless, opponents of loans still argue that the costs, the dangers and the administrative problems would outweigh the advantages of introducing loans, and proposals to introduce loans still rouse considerable controversy.

Proposals to Introduce Student Loans

In Britain, for more than twenty years some writers have recommended the introduction of student loans, and in 1986 the government announced a review of student aid policy which will re-examine the option of loans. The arguments put forward both for and against student loans in Britain have also been echoed in other countries where systems of student support are under review.

Advocates of loans argue that a system of student support based partially or entirely on loans is more efficient and equitable than a system relying wholly on grants.

The advantages claimed for loans include:

(a) a reduction, in the long run, in the costs of subsidising students, thus allowing the government to expand higher education, to reallocate the savings to other levels of education, or to reduce the financial burden on the taxpayer;
(b) less transfer of income from low-income taxpayers to those who are likely to enjoy higher than average incomes in the future;
(c) improved motivation of students, who would become more cost-conscious and more thoughtful about future career prospects;
(d) greater flexibility than a system which gives grants to certain categories of student and denies any form of financial aid to others, such as part-time students or students in private universities.

On the other hand, the critics of student loans continue to draw attention to potential problems. For example, in Britain, the National Union of Students, which has long opposed the intro-

duction of loans, even on a partial basis, produced a strongly worded attack in 1985 which concluded that "none of the systems observed meet the needs of students, education, government or the country concerned" (NUS 1985). Critics of loans argue that replacing grants by loans would:

(a) discourage low-income students from participating in higher education, because of their fear of incurring future debts;
(b) provide a particular disincentive for women, who would face a 'negative dowry' if they married while still having unpaid debts;
(c) be difficult and costly to administer, particularly at the repayment stage;
(d) lead to little or no savings of public funds, because of the danger of default.

Despite the controversy surrounding student loans, there have been recent proposals to introduce loans in many countries, including Australia, New Zealand, Ghana, Kenya, Nigeria, the Ivory Coast, Malaysia, and Papua New Guinea. In addition some countries, such as Barbados and Indonesia, where loan programmes were introduced in the 1970's or early 1980's, have recently considered expanding the existing system of loans.

The Need for Practical Advice: The Purpose of this Book

Despite the renewed interest in loans as a means of financing higher education, and the frequent proposals in various countries to introduce or expand loans for students, there is very little practical advice available for the policy maker who is actively considering establishing a loan programme. As more governments consider introducing loans as a way of overcoming financial constraints, it becomes increasingly clear that what is needed is not further theoretical debate about the advantages and disadvantages of loans, but practical information about existing programmes, their strengths and weaknesses, and about the range of options available to a policy maker who is considering introducing a student loan programme. With more than thirty countries providing student

Proposal for a National Student Loan Bank in Malaysia

A recent examination of the Malaysian government scholarship policy concluded that the system of scholarships was:

- *generating a mismatch between the supply and demand for high level manpower*
- *highly regressive, and chiefly benefitted students from wealthier families.*

The authors recommend the establishment of a National Student Loan Bank, to provide repayable loans to all students, both for overseas and local university study. "Even poor students will, thanks to their education, ultimately emerge as relatively rich members of society and, therefore, they should be expected to discharge their social accountability to the next generation by repaying their loans." (Mehmet and Hoong 1985, p. 208)

loans, and with several countries offering more than one type of loan, there is a bewildering variety of models and an even greater multiplicity of variables to consider in designing a loan programme. The purpose of this book, therefore, is to examine the range of choices facing the policy maker who has been convinced of the merits of establishing some sort of loan programme but is unsure of the advantages or disadvantages of different types of loan scheme.

The emphasis is on practical choices rather than on the theoretical case for introducing loans. The book is written to provide practical assistance for a policy maker who is willing to embark on the process of establishing a loan programme, perhaps initially only on an experimental basis, but is unsure what prior decisions and choices have to be made before a loan programme can be set up. The focus is mainly on the possibilities for establishing a loan programme in a developing country. For this reason, particular attention is given to the problems faced by

national policy makers in developing countries, who are likely to see the main advantages of student loans in terms of a reduction in the public costs of higher education.

There are of course other issues that must be considered, including the impact of student loans on patterns of participation in higher education, on student choices and motivation, and on educational institutions. Many of these issues are also of particular concern at the moment in several developed countries where student loans are currently under scrutiny, for example the USA and Sweden, or countries which are considering introducing loans, for example Britain. However, this book is addressed primarily to the policy maker or administrator in a developing country; and though it draws on the experience of loan programmes in developed countries, including the USA, Japan, Canada, Sweden and West Germany, it is mainly concerned with the lessons of such experience for developing countries, and with experience of actual loan programmes in developing countries.

The remainder of the book is divided into two parts. The first part deals with policy choices. Chapter 2 considers the choices facing the policy maker, in terms of ten crucial decisions that have to be made, and the evidence that is available on the advantages and disadvantages of different models. Chapter 3 shows how a computer model can be developed to examine the implications of alternative choices. Part II provides more details of actual experience. Chapter 4 summarises experience in both developed and developing countries, and provides more detailed information on Colombia, Barbados and Hong Kong, as case studies of countries which have established student loan programmes.

There is no single 'ideal model' put forward in this book, for the simple reason that the choice between alternatives must depend in part on the conditions within the country, including the existing pattern of finance for higher education, and factors such as the size of a country and its state of development. Above all, it must depend on national objectives and priorities, and the specific aims of the policy maker in introducing student loans. In some countries, the aim of a loan programme may be to expand financial aid for students, which will lead to increases in expenditure; in other cases the aim is to reduce the level of public subsidy and

substitute loans for grants, scholarships or bursaries, or increase cost recovery through fees.

Some of the choices facing the policy maker in designing a student loan programme are political. For example:

* how should the costs of higher education be shared between students, their families and the taxpayer?
* should loans be available to students in private as well as public universities?

Other choices are more technical:

* what should be the repayment terms of student loans?
* what steps should be taken to minimise default?

This book examines both types of choices, and shows how different decisions have been made in different countries.

However, what will work in one situation will not necessarily work in another country facing different economic and political conditions. Therefore, rather than providing a 'blue-print' for a student loan programme, the book aims to provide the policy maker with a framework for examining some of the implications of alternative choices. It is hoped that this will prove useful, if only as a 'check list' of problems to be solved before a student loan programme can be established.