

Cost-sharing and Equity in Higher Education: Implications of Income Contingent Loans

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This paper explores the fitful saga of cost-sharing in European higher education, and some implications of the current (2003) interest in *income contingent loans* for recovering a portion of the costs either of student living or tuition fees or both. Europe is the last bastion (some might say *the last refuge*) in the world of fully (or almost fully) tax-supported higher education, extending in many countries beyond free higher education to at least some governmental, or taxpayer, responsibility for expanding higher educational participation and equity with need-based grants covering some of the costs of student living. However, there is a long tradition in Scandinavia of the *student* bearing all or most of the financial responsibility for food, lodging, and other costs of student living—generally through partially subsidized student loans (in Sweden, loans of the *income contingent* variety). This long tradition of student contributions in Scandinavia, plus the increasing expenses of student living costs everywhere in Europe, coupled with low and frequently diminishing (in the UK virtually *disappearing*) cost-of-living grants from the government, has kept the question of student contributions--and thus of student loans--at least *on the table* in many countries of Europe.

The advent of tuition fees—implying a greater share of the actual costs of instruction borne by parents as well as by students, and which can be seen on a modest scale in the Netherlands, Portugal, and most recently Austria, and on a more substantial scale in the UK--extends *cost-sharing* to a far more economically significant as well as a more ideologically controversial arena (at least in Europe). The spread of cost-sharing in Europe, then, implying parental and/or student shares of both the costs of instruction and the costs of student living, although still lagging behind most other countries of the world, has profound implications for the spread of market forces to higher education generally as well as for the realization of the virtually universal objective of preserving and expanding equity. And in this saga, student loans—which make possible a student share of this cost burden—will almost certainly grow in importance to European higher education policies.

This paper will look first at the implications of *cost-sharing*, or the shift of higher educational costs from exclusive or near-exclusive financial reliance on government, or the taxpayer, to being shared with parents and/or students.¹ We will consider especially

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¹ This paper is considering cost-sharing and the phenomena of privatization and marketization within the public, or at least the publicly financed, higher education sector, which in all of Europe remains the overwhelmingly dominant sector in spite of the rapidly emerging privately-owned, tuition-dependent

the implications of cost-sharing to several different notions of higher educational *equity*. We will then consider the implications of *income contingent loans* as a means of implementing a measure of cost sharing. We will look especially at the implications of such loans to the two principal (and at least partially conflicting) purposes of any student loan program: (1) to effect a real cost recovery as evidenced by a shift of some of the higher educational cost burden from taxpayers to students; and (2) to expand participation (thus advancing *equity*) to some who would likely have been excluded in the absence of this cost-sharing—and of the particular *income contingent* form of student loans.

This paper addresses the theme of higher education and market forces in the policy context of the important and virtually universal goal of higher educational equity, and in the programmatic context of the increasing popularity of income contingent loans (sometimes mistakenly termed “graduate taxes”) as currently employed in Sweden, UK, South Africa, Australia, New Zealand, and to a much more limited extent, the US. (Income contingent loans are also being urged by their proponents in some of the formerly Communist countries in Eastern and Central Europe as well as in many developing countries.) We will look especially at the current (2003) fascination with the Australian Higher Education Contribution Scheme (HECS), which embeds the incorporation of a tuition fee² within a system that allows the fee to be either paid “up front,” as a direct tuition fee (presumably mainly by parents) or deferred and assumed by the student via an income contingent loan. This is the system that was adopted in 2001-02 in Scotland as an alternative to the (then) UK “up-front” tuition fee and that is currently (2003) “on the table” for adoption in the rest of the UK according to the Government’s 2003 White paper.

Cost Sharing in Higher Education

The concept of *cost-sharing* as developed by Johnstone (1986, 2002, 2003a) begins with a presumption that the underlying costs of higher education are borne by some combination of four parties: *government* or *taxpayer* (via direct or indirect taxation or even by inflation³); *parents* (via savings, borrowing, or current income); *students* (via savings, current earnings, or borrowing); or *philanthropists* (via endowments or current contributions). Cost-sharing as a governmental policy generally refers to a shift of at least some of these costs from a substantial reliance on governments or taxpayers to a greater reliance on parents and students. Cost-sharing is especially thought of as the introduction of, or especially sharp increase in, *tuition fees* to cover part of the costs of instruction. In Europe, the UK is an example of a recently introduced tuition fee, in 1997. Austria in 2001 became the first German-speaking country to introduce tuition fees for all students

institutions in post-Communist Eastern and Central Europe, Russia, and the other European countries of the former Soviet Union.

² In the UK and elsewhere (except US), the word *tuition* means *instruction*: thus the price one must pay for instruction needs to be called a *tuition fee*. In the US, the word *tuition* has come to mean only the fee, and so the term *tuition fee* would seem redundant. However, this paper will follow the UK usage and generally refer to the *tuition fee*.

³ It is important to bear in mind that the “taxpayer” can also be the average citizen consumer or even worker whose real take-home pay is diminished by the government in indirect forms of taxation, such as payroll taxes, or even business taxes (which leave less revenue to be distributed to workers), or even (the most regressive form of taxes) to deficit finance-induced inflation that only indirectly, but still assuredly, removes the purchasing power from the ordinary citizen or worker.

(although the fees remain nominal). The US is an example of a country that has already shifted a significant portion of higher educational costs to parents and students via tuition fees—ranging in the public higher education sector in the early 2000s from “lows” in the neighborhood of \$1,500 to “highs” in the range of \$4,000 to \$6,000 (and much higher for out-of-state students and for advanced professional students) and in the private sector from “lows” in the neighborhood of \$10,000 to “highs” in excess of \$25,000. The US public higher education sector in particular has continued the shift via especially sharp increases in public sector tuition fees that have far outpaced not only the cost of living, but the rise in the underlying costs of higher education, thus compensating (but only partly) for the very considerable cuts in state funding (Johnstone 1999 and 2004).

Cost sharing can also take the form of *user charges* to cover more of the costs of lodging, food, and other expenses of student living that may have hitherto been born substantially by governments (taxpayers) or institutions. In fact, much of Europe has traditionally assumed living expenses to be the responsibility of other-than-the-taxpayer, although there are difference in whether these expenses are assumed to be the responsibility of parents--as in Germany, France, and most of Southern Europe--or of the students themselves, via universally-available loans—as in Scandinavia.

Less noticeable shifts in the prevailing patterns of cost-sharing—almost always in the direction of shifting burden from the taxpayer to the parent and/or student-- include the introduction of small, *non-instructional fees* (with the advantage of not having to be called *tuition* fees), the freezing or diminution of student support grants (especially in an inflationary economy), the channeling (sometimes with some governmental resources) of more students into a tuition-dependent private sector, or in the few countries that have introduced significant loan programs, an improvement in recovery rates (i.e. a lessening of needed public subsidies) via an increase in the rate of interest or an improvement in collections.

A form of tuition fee that is especially popular in formerly Communist or Marxist countries--where there is likely to be especially intense ideological opposition to the very concept of cost sharing, but where there is also likely to be a desperate need for the revenue that can rather easily be generated by tuition fees--is the so-called *dual track* tuition fee, in which students who are *not* academically accepted into the small and selective pool of fully state-supported positions may still be admitted *for a fee*. Such a system maintains a kind of fiction of free higher education even in Russia, for example, where the revenues from tuition are approaching 50 percent of all university revenue in spite of an official policy of free higher education (Bain, 2001).⁴

The rationale for cost-sharing has been the subject of a large and well-accepted (even if politically and ideologically contested) body of economic and public finance theory. Much of this rationale focuses on the presumed greater efficiency brought about when there is a charge, or a price, that reflects (even with a substantial taxpayer subsidy) at least some of the real costs and the trade-offs involved. Thus, higher education that is

⁴ *Dual-track* tuition is also seen in several countries of East Africa (also with Marxist legacies) where, for example, Makerere University in Uganda, arguably one of the most successful in Sub-Saharan Africa, admits as many as 80 percent of its students on a tuition fee-paying basis in spite of the official governmental policy of free higher education. See Johnstone (2003b)

free to the student-family “consumer” can, by virtue of this degree of subsidization, either be *over-consumed* (that is, too much partaken of, or too much partaken of by students with insufficient capacity to benefit, and/or or at too great a cost) or *consumed with insufficient academic effort*, presumably because there is no cost incurred by either the student or his or her family and therefore nothing foregone by the participation. Some tuition fee is thus assumed to induce both a harder working student and one who is more perceptive and demanding of the institution. And the institutions, at least in theory, have an incentive to hold down their tuition fees in order to attract and retain the student (or the parent), thus presumably becoming more efficient (or at least less wasteful), and also to provide what the student is likely to want—which is also likely to be what the potential employers want.

In fact, the most compelling case for cost sharing in the transitional countries of the former Soviet Union and Eastern and Central Europe, the developing world, and even in the advanced industrial countries of Europe and the rest of the OECD countries, may rely less on the economist's presumptions of theoretically superior efficiency and equity (as valid as these presumptions may be) and more on the much simpler to grasp--and much less controversial--*sheer need for alternative (i.e., non-governmental) revenue*. This need, in turn, emerges from the long and compelling queue of competing public needs (even in Europe) as well as the political pressure for tax relief. The increasing pressure on public revenues in Europe and the other highly industrialized nations is exacerbated by the effects of *globalization*, which increases the predilection, as well as the ability, of taxable individuals and enterprises to escape to lower tax venues. And by most calculations, a substantial portion of this non-governmental revenue is going to have to come from parents and students in the form either (or both) of tuition fees.

Cost-sharing thus takes on many different forms. But in whatever form or forms, cost-sharing is generally increasing throughout the world, including the advanced industrialized world, at the start of the 21st century. For example:

- *The US*, where the costs of higher education--high and rapidly rising over time to begin with--have been rising even faster in that share borne by parents and students. Tuition fees at public universities rose by some 84 percent in the decade of the 90s as the share borne by governments, or taxpayers diminished (NCES 2002). Public sector tuitions and fees vary widely—mainly by state and type of institution rather than by degree program--but range for undergraduates from a low of around \$2000 to a high of \$5000 and more, and at least double that amount for students from another state. Total expenses to students range from a low of about \$5000 for students at community colleges living with their parents, to a high range from \$35,000 to \$40,000 a year living in residence or independently at a prestigious private college or university (Johnstone, 1999, 2001b). The US, however, has extensive programs at both the state and federal levels of government and from the colleges and universities themselves, of “need-based,” or “means-tested” grants and minimally subsidized loans, such that all students—at least of traditional college-age, and albeit with loans and part-time employment--can afford at least the public college or university, and the most able students, regardless of the income of their family and albeit with extensive loans, can be assured of sufficient financial assistance to attend the most expensive institution.

- *The UK* in 1997 became the first European country to impose more than a nominal tuition fee—although it is still low by US public college and university standards. The tuition fee in England and Wales is (2003) £1500 and can be covered by need-based grants and loans, to be repaid as a portion of their earnings, or “income contingently.” The Government, in the form of a white paper that is “on the table” in the year 2003 (Department of Education and Skills [UK] (2003) is proposing to replace this “up front” tuition fee with a tuition fee that would be deferred for all students and repaid after graduation at a rate of interest equivalent to the increase in the general cost of living (i.e. a zero *real* rate of interest). This would make England and Wales much closer to the cost-sharing arrangement in *Scotland*, which was allowed in 2001 to replace its “up front” tuition fee (paid for by parents, albeit means-tested) with a mandatory income contingent loan (paid for by students), called a “contribution” to the Scottish University Endowment Fund. (Department of Education and Skills [UK] 2003, Richards 2002).
- *Australia*, inaugurated the Higher Education Contribution Scheme (HECS) in 1989 as a way of combining a tuition fee with a scheme that allowed most students to defer this tuition and repay as an income contingent loan at a rate of interest that would mirror the prevailing Australian rate of inflation. The tuition in 2001 was about \$2600 (US) for undergraduate arts and sciences and could, in lieu of the income contingent loan, be paid “up front” at a discount. (Chapman, 2002a, 2002b).
- Other examples include *Sweden*, where there is no tuition fee but where students receive study assistance to cover living expenses and repay via income contingent loans; *Germany*, where there is also no tuition fee but where a means-tested student assistance grant is partly repayable as a conventional, very highly subsidized, loan; *Austria*, which “broke ranks” with the rest of German-speaking Europe and began charging a tuition fee in 2001; *Russia*, where the universities are legally *free*, but where the dual tuition program allows up to one-half of all Russian university revenue to come via tuition fees; or *China*, which abandoned its dual tuition scheme in 1997 to charge all students a tuition fee that is high by the per-capita income of the country, but that has provided a great deal of revenue for China’s rapidly expanding system of higher education.⁵

Opposition to Cost-Sharing and the Issue of Higher Educational Equity

Cost-sharing—particularly the imposition of or sharp increase in tuition fees—is contested on many grounds. Much of the opposition to tuition fees, aside from that which is simply *self-serving* (that is, the understandable opposition to paying for something that was at one time paid for by someone else) is based on the allegation that tuition fees are *inequitable* as they inhibit or discourage the children of the poor (and the rural and those of ethnic or linguistic minority status or girls) from attending higher education. The relationship between cost-sharing (or tuition fees) and equity is a complex and contested one, to which we now turn.

⁵ For cost-sharing information of some 35 countries, see the International Comparative Higher Education Finance and Accessibility Project website at <<http://www.gse.buffalo.edu/org/IntHigherEdFinance/>> (November 2003).

Equity in higher education has very different meanings and connotations. A core meaning is that higher education should be *equitably accessible*: that is, accessible to all with the interest and the academic ability to benefit. By this narrow construction of higher educational equity, interest and academic ability, or *academic preparedness*, are acceptable correlates to higher educational participation, whereas attributes such as the socio-economic class, occupation, race, religion, language, or ethnicity of one's parents, or one's gender are generally thought to be unacceptable correlates to participation. By this construction, cost sharing can be made more-or-less equitable to the degree that need-based grants and/or generally-available student loans are provided to those students from low income families to make up for the revenues not forthcoming from the parents.

The problem with this construction of educational equity is that there is in all industrialized countries a substantial and persisting correlation between these so-called *acceptable* and *unacceptable* correlates: that is, children born into poverty or into an ethnic or linguistic minority group are statistically less likely to exhibit the interest and academic preparation for higher education and thus will be statistically less likely to participate—in spite of those children from the remote countryside or from very poor parents who surmount these odds and succeed in their academic high schools (see Farrell 1999). Most of this insufficient preparation or ambivalent interest has little to do with the presence or absence of tuition or other elements of cost-sharing, or of the availability of financial aid in the form of need-based grants and generally-available student loans. However, to the degree that young people of low income, or ethnic or linguistic minority, or rural or otherwise isolated, backgrounds may be more ambivalent about the opportunity costs of higher education (that is, about foregoing the income from directly entering the workforce) or about the sacrifices and/or risks entailed by incurring indebtedness, even need-based grants and generally-available student loans might not be enough to maintain equitable participation under a policy of shifting cost burdens onto students. The assurance of genuine equity in a country moving in policy directions of greater recognition of market forces and/or more cost-sharing, then, almost certainly requires a special sensitivity to, and possibly additional financial compensation for, the fundamentally greater *ambivalence*, the greater *perceived opportunity costs*, and the arguably greater *debt aversion* of those from low income, rural, or ethnic/linguistic minority backgrounds or, in some cultures, of females.

Some critics of cost-sharing are fundamentally opposed to cost-sharing on the mainly ideological ground that higher education, like elementary education and other basic needs, simply ought to be free—that is, paid for by all citizens/taxpayers. Some attempt to buttress this argument by asserting that the overwhelming preponderance of benefits are *social*—an assertion, however, that is not well supported by econometric evidence. Other critics take a more pragmatic and political view, asserting that cost-sharing accompanied by need-based grants and generally-available loans might be theoretically compatible with equity, particularly if the grants are generous enough to compensate for the likely debt aversion and greater *felt* opportunity costs of the poor or of girls or of rural or ethnic minorities. To these critics, however, the problem is that sufficient need-based grants are simply never a high enough political priority, and that

when revenue shortfalls occur or other pressing public priorities emerge, politicians are too apt to accept the high tuition but fail to deliver the promised high aid.⁶

An altogether different construction of higher educational equity is *fairness*, based on the notion that those who benefit should bear at least some of the costs. Under this construction, free tuition is *inequitable* because the children of the wealthy in all countries disproportionately benefit, while all taxpayers /citizens (whether contributing via direct taxes, indirect taxes, or the confiscation of purchasing power through deficit spending-induced inflation) bear the costs. This is the classic liberal economic critique of free tuition. From this construction of *equity as fairness*, free higher education is most inequitable--and therefore cost-sharing is most likely actually to further the cause of greater higher educational equity--to the degree that: (1) higher educational participation is minimal, including only the most interested and best prepared; (2) the children of the wealthy and powerful disproportionately benefit from this rationing of the free higher education via their greater access to good schools, academic role models, and other forms of cultural capital; and (3) the taxes used to support the “free” higher education are proportional or even regressive. Also by this construction, then, “free” higher education that is supported by relatively progressive taxes and is more-or-less universally partaken of, with little if any correlation between higher educational participation and the unacceptable correlates of socio-economic class, gender, and ethnicity, would be essentially *equitable*—or at least *not inequitable*.

One of the major policy issues in higher education is whether, at the end of the day, the powerful trends toward greater cost-sharing and other forms of higher educational privatization and market orientation that we have been observing around the turn of the 21st century are compatible with our deeply-held values of equity and social justice. The answer that most academic leaders, interested politicians, and policy analysts would give is that these trends can be—but only with policies and resources that provide, among other things:

- need-based, or means-tested, financial assistance in generous enough amounts not only to compensate for the missing parental contributions of the children of low income parents, but to at least partially compensate for the greater ambivalence and felt opportunity costs of those children and young adults who are likely to be missing some of the culturally-based academic ambition and vision of their more socio-economically fortunate age peers;
- in the same way, students loans to cover some of the costs both of instruction (i.e. tuition fees) and of student living—in sufficient amounts and with sufficiently manageable repayments schemes to encourage children and young adults to invest in their own further education;

⁶ This critique is especially compelling in low-income countries where student loans have simply not worked—for all kinds of reasons. See Colcough (1991) for an effective presentation of such a view. See Johnstone (2000, 2002) for a rebuttal, pointing out that that most of the student loan program failures in Sub Saharan Africa, for example, are essentially faults in program design and should have been anticipated, and that the right combinations of program design and efficient execution, with the exception of South Africa, have simply not occurred.

- public information (*public relations*, as it were) aimed at the children of the poor and the rural and at ethnic and/or linguistic minorities and girls—in short, at all who may have been historically underrepresented in higher education—to urge not only the importance but also the feasibility (especially the financial feasibility) of tertiary education;
- admission policies that screen appropriately for academic talent and interest—with sensitivity to the virtually universal cultural biases of most measures of academic preparedness and commitment; and
- continued attention to the most problematic origins of socio-economic educational screening, which are in the middle and secondary school years and which require the greatest political attention and public resources.

With such policy attention and public resources devoted to the furtherance of higher educational equity, the superior efficiency, responsiveness, and fairness associated with cost-sharing and privatization—and with the additional public revenues made at least theoretically available by this greater efficiency—the seemingly inevitable trend toward a greater orientation to markets in higher education can be not only compatible with, but may actually enhance, our social and political attention to equity and to other public values in the academy. Expressed another way, if the trends are as ineluctable as they appear to be, and if there will almost certainly be fewer public revenues to continue free higher education plus generous need-based grants for the costs of lodging and food, then some further movement in the direction of greater cost-sharing in the mature industrialized countries seems virtually inevitable. And if this is so, then the combination of cost-sharing with the optimal amount and form of financial assistance—including opportunities for student borrowing—has the ability to increase the total revenues to higher education and to better focus the available public revenues in support of higher educational equity.

Student Loans

Student loans, or any other sort of what are sometimes called *deferred payment plans*--including all forms of income contingent and so-called *graduate tax* schemes as well as more conventional, or mortgage type, forms of lending are integral to any policy that features a share of higher educational costs to be borne by students. Student loans purport to achieve two distinct and basically contradictory aims. In the first place, such schemes are usually part of a policy of *cost-sharing*, as described above. Second, loan schemes are ways to enhance participation or accessibility, and thus *equity*, either (or both) by increasing the total revenue stream and thus expanding higher education's capacity (and thus its accessibility), and also by making it possible for would-be students without parental or other sources of support nonetheless to invest in their own higher education.

Student loans may take one of two basic forms, with many variations of each and with “hybrid” versions of the two also possible.⁷

⁷ This section draws extensively on Johnstone (2000) “Student Loans in International Perspective: Promises and Failures, Myths and Partial Truths” available from the International Comparative Higher Education Finance and Accessibility Project at the University at Buffalo’s Center for Comparative and Global Studies

Conventional Loans. A conventional, or “mortgage-type,” loan carries three contractual elements: (1) a *rate of interest* expressed as an annual percentage of the amount borrowed or still to be repaid (which may be fixed or may vary according to some index such as the government’s borrowing rate or the calculated annual rate of inflation); (2) a *repayment period*, or the amount of time the borrower has to repay the loan; and (3) a *repayment mode*, such as whether the payments are to be in equal monthly installments, or installments that begin small and increase over time, or some other arrangement that yields a stream of payments sufficient to amortize the loan at the contractual rate of interest.

Income Contingent Loans. An income contingent (or “contingent repayment”) loan carries a contractual obligation to repay some percentage of future earnings (sometimes per \$1000 borrowed) generally until the loan is repaid at the contractual rate of interest (whether subsidized, unsubsidized, or *premium*--that is, designed to generate a surplus) or until the borrower has repaid for a maximum number of years. The borrower who has repaid the maximum number of years without paying off his or her loan at the contractual rate of interest is released from further obligations and thus granted a subsidy, or an *effective grant*. This subsidy is given not on the basis of the current low income of the borrower’s family at the time of the original loan, but on the basis of the borrower’s own low income over an effective earning lifetime--that is, on the basis of his or her higher education never really “paying off” monetarily.

Elements that are stipulated in the income contingent loan contract are (1) the annual repayment burden, or the percentage of income or earnings that must go to loan repayment (which may be fixed for all income levels or *progressive*, increasing at higher incomes); (2) the stipulation of precisely what is to be counted as *income* and over what span of time (for example, last year’s *actual taxable*, or the current year’s *estimated gross*); and (3) the provision for release from further repayments (which would be either repayment in full at a contractual rate of interest or, in the event of low income and the consequent inability to repay in full within a reasonable period of time, repayment for a maximum repayment period or until a maximum age). The elements of an income contingent loan that vary according to income or earnings, then, are: (1) the actual monthly or yearly repayments, (2) the repayment period; and (3) the ultimate (i.e. after the final payment is made) cost of the loan expressed as an overall effective interest rate on the original amount borrowed. (This is in contrast to a conventional loan, which stipulates the rate of interest, repayment period, and repayment mode—and thus the required monthly or annual payments—but in which the *burden of repayments*, varies according to income or earnings.)

Graduate Taxes. A variant on the income contingent loan is the graduate tax, whereby the student (sometimes only the graduated student), in return for government subsidization of higher education in the form of low or no tuition (and possibly of an additional student maintenance grant), becomes obligated to an *income surtax*, generally for the rest of his or her earning lifetime. A true graduate tax is just that: An income surtax on university graduates, without the keeping of individual borrower accounts or

in Education or at the Project website <<http://www.gse.buffalo.edu/org/IntHigherEdFinance>>. The section on income contingent loans draws on Johnstone (1972).

“balances owed.” However, because the purpose of a graduate tax—like any governmentally-sponsored student loan plan—is to shift a portion of the costs of higher education from the government or taxpayers to students, but to be paid only after the student has finished (presumably graduated) and is earning an income (supposedly higher because of the higher educational experience), the financial success of the *graduate tax*, like the success of any other student loan, must be measured by the discounted present value of this stream of future income surtax payments. Thus, the mathematics and the practical effect on participating students of the graduate tax and the income contingent loan—assuming similar terms—are practically indistinguishable. (It should be noted that there has never been, though the year 2003, a true operational *graduate tax* according to the definition just given; most references to graduate taxes actually refer to income contingent loans that do, in fact, maintain “balances owed.”)

Student Loans, Cost-Sharing, and Equity. The degree to which a student loan program, whether conventional, income contingent, or a hybrid version between these two models, serves the goal of cost sharing—i.e., supplementing taxpayer revenue with student and/or parental revenue—depends on the net cost recovery of the program. This may be viewed as the discounted present value of the reasonably anticipated repayment stream, net of defaults and servicing/collection costs. This value, in turn, depends on three elements: (1) the degree of “built in,” or “best case,” subsidization, which is a function of the cost of money, the interest rate charged to borrowers who repay in full, the repayment periods, and the number of low-earning borrowers who, in the income contingent plans, will eventually be released from further repayment obligations with balances outstanding; (2) anticipated defaults (mainly, although not exclusively, within the conventional repayment plans); and (3) the costs of servicing and collections.

On the other hand, the degree to which a student loan program serves the goal of higher educational equity—i.e., reducing the link between higher educational participation and the aforementioned *unacceptable correlates* of socio-economic class, gender, ethnicity, and the like—depends on the degree to which the loan program makes possible participation that would be unlikely in the absence of this student borrowing. And insofar as virtually all generally available student loans programs require some public subsidization—and thus must be viewed as *trade offs* for other equivalently costly ways to expand participation and equity—the taxpayer costs of the student loan program, including all publicly-funded subsidies, administrative costs, and guarantees against default, must be compared alongside alternative public expenditures to the same end, such as free or highly subsidized tuition fees for all, or additional need-based grants. In this comparison—because only a loan program makes possible a substantial contribution from the student him or herself—a student loan program that is minimally-subsidized, efficiently administered, and experiences modest defaults (all of which are possible in advanced countries) has the theoretical ability to release some public revenues from the support of all instructional expenses to be used in various targeted ways to advance participation and equity.

Income Contingent versus Conventional Repayment Obligations: Misunderstanding, Misrepresentation, and Unintended Consequences

As an optional mode of repaying a student loan, the income contingent repayment form has some theoretical as well as practical advantages and has attracted (for quite

different reasons) the attention of economists, politicians, and students alike. In fact, knowledgeable proponents of income contingent loans such as Australia's Bruce Chapman (Chapman 2002, Chapman and Ryan 2002) and the UK's Nicholas Barr (2001), proclaim income contingent loans to be *ipso facto* superior to all other forms of student lending. However, income contingent loans are also thoroughly confounded with misunderstandings, misrepresentations, and unintended consequences. As an example of a *misunderstanding*, much of the popular attractiveness of income contingent loans is not the property of *income contingency* per se, but of the extent and type of the built-in governmental subsidization of a particular loan plan or of the use of the government's machinery of income tax withholding and pension contributions—either of which could be extended just as well to conventional, mortgage-type loans. In addition, there are certain disadvantages in the income contingent loan form that seem insufficiently recognized by their proponents. (These genuine disadvantages, incidentally, are generally *not* the alleged disadvantages cited by student groups and others simply opposed to any form of tuition fees and/or student loans.)

There is also, whether intended or not, particularly in the political advocacy of income contingent loans what would appear to be *misrepresentation*—as in the employment of income contingency to effectively obfuscate the true nature of tuition fees, the implications of student indebtedness, and how particular plans shift the higher educational cost burdens among taxpayers, parents and students. This misrepresentation (if it indeed be that) may be politically expedient. But it may also simply postpone more difficult but necessary actions on the part of government and/or encourage students to borrow more than they would otherwise intend.

Finally, as in so many public policies forged in ideological conflict and political compromise, there may be *unintended consequences*—or at least consequences that were almost certainly unintended by some of those responsible for the policy and its details. In the case of the Australian Higher Education Contribution Scheme, its “look alike” adoptions in Scotland and Wales, and its serious entertainment by the UK Government for the rest of the UK, a consequence that appears to be unintended (at least to some) is a shift in the higher educational cost burden not from parents and students to governments and taxpayers, but from parents (who can and do pay) to students in the form of additional indebtedness.

In short, while the income contingent repayment form does have attractive features, it is well to keep in mind several qualifications, or caveats, to the common presumption of the superiority of the income contingent loan form.⁸ In the first place, an income contingent loan is still a loan and is not per se any “cheaper” for most students than a conventional loan merely because the repayment obligation is expressed as a percentage of income or earnings. The *cheapness* or *expensiveness* of a loan—not to be confused with the *manageability of its repayments*—is measured by its “true” simple annual interest rate (or the discounted present value of the repayment stream). In any

⁸ For elaboration on these points, see Johnstone, “Student Loans in International Perspective: Promises and Failures, Myths and Partial Truths” (2000) and “The Economics and Politics of Income Contingent Repayment Plans” (2001), both are available from the International Comparative Higher Education Finance and Accessibility Project at the University at Buffalo's Center for Comparative and Global Studies in Education, or from the Project's website provided in notes # 4 and 5, above.

income contingent loan, most borrowers will still repay their loans “in full” at whatever interest rate is built into the provisions of the loan, depending on how generous the government (or any other lender) aims to be. Both the Australian and the UK plans aim to collect from most borrowers a *zero real* interest rate—that is, a rate of interest that mirrors the prevailing rate of inflation. South Africa aims to collect a *2 percent real* rate of interest—that is, 2 percentage points above the prevailing rate of inflation. The US income contingent loan, on the other hand, aims to collect through those loans to be repaid *income contingently* the same rate that is charged on other repayment modes—which in 2002 was 8.25 percent. If there is a special advantage to the borrower in the degree of subsidization, it is not from the income contingent nature of the repayment obligation.

Some proportion of low earners, of course, fare better in an income contingent plan. But the degree of low earnings subsidization is a function of the percent of income or earnings to be repaid and the number of years that a low earning borrower will be “held in repayment” attempting to repay “in full.” Thus, the degree of *low earner subsidization* is separate from the degree of subsidization accorded to *all* borrowers—and each is a function of the particular features built into the particular plan. An income contingent loan scheme can provide especially generous subsidization to the lifetime low earner by means of a low percent-of-income repayment rate and a short maximum repayment period. Or, an income contingent scheme can require almost all borrowers to repay their loans at the same interest rate, requiring low earners to repay for extremely long repayment periods and reserving real *repayment forgiveness* only for the truly destitute.⁹

Second, some of the attractiveness attributed to income contingency—specifically, the presumed convenience to the borrower and the presumed greater certainty of repayment (and thus of lower defaults) to the lender, or the government—comes primarily from the government’s willingness to enlist the policies and procedures of income tax and pension or insurance withholding to the cause of collecting student indebtedness. But this machinery, including the power to mandate employers to collect such sums at the point of wage and salary payments, as well as the government’s power to verify compliance and punish transgressors, could in theory be applied as well to the collection of conventional loans—or, for that matter, to the collection of any payment owed by citizens the effective collection of which is deemed to be of overriding public importance (e.g. local taxes, child support, alimony, traffic fines, philanthropic contributions, or tort judgments).¹⁰

Third, an income contingent loan presents major complications not found with conventional “mortgage-type” loans. Most of these arise from the need to stipulate

⁹ This is quite clearly the case in the US optional income contingent repayment mode, which has not been popular with students in part because of its extreme complexity, but in part also because only the very destitute stand to gain any ultimate forgiveness, with all others paying until their loans are fully repaid at the same rate of interests as on other conventional student loans.

¹⁰ An obvious corollary to this presumed advantage, of course, is that a government that *lacks* the power and/or established means of collecting taxes and pension contributions from all or nearly all of its citizens can hardly be expected to be able to collect much of any payments on income contingent loan or graduate tax obligations.

precisely, and to be able then to verify, the income that is effectively to be “taxed” in order to arrive at the proper repayment amount. Multiple sources of income, highly variable income, income that tends to not get reported all, and income that can be easily shifted between a borrower and a non-borrower member of the family all constitute great problems for the viability of an income contingent loan scheme. OECD countries, with extensive reporting and monitoring of virtually all income and with a culture of voluntary income tax compliance may be able to overcome these problems, as Sweden and Australia seem to have done. For other countries, where sources of income or earnings are frequently multiple, highly variable, and generally unreported, the problem of establishing the repayment obligation will be an enormous problem and one that virtually invites misrepresentation of income and almost certain repayment shortfalls. (This is quite clearly the case in virtually all developing and transitional countries; but may also so the case in many European countries where income tax evasion has been carried to a high art. see Johnstone 2001a, 2003b.)

Finally, following upon the observations above, it is not as clear as it is often proclaimed that an income contingent loan will be superior on the criterion of effective cost recovery. Student loan plans, whether conventional or income contingent, will recover insufficient repayments to the degree that the plan: (1) carries too great an interest subsidy (i.e. is initially designed to recover far below the true opportunity cost of money); (2) incurs excessive defaults or consistent underpayments; or (3) is excessively costly to service. It follows, then, that successful plans—at least on the criterion of effective cost recovery—will be minimally subsidized and will experience minimal defaults, underpayments, and administrative costs. The appropriate question for our analysis, then, is whether an income contingent or a conventional form is apt to be better on the criterion of actual cost recovery *assuming that either plan would carry the same degree of built-in taxpayer subsidy and that either would have the same access to whatever governmental machinery existed for the collection of tax withholding and pension contributions at the point of wage and salary payment.*

The question posed in this way can only be answered in theory, as the purportedly successful income contingent loan programs such as those in Australia, New Zealand, Sweden, and South Africa have never been compared “side-by-side” to a conventional loan program operating in the same culture and with the same access to governmental subsidies and to the government’s tax and pension withholding machinery. In theory, however, the two repayment forms are likely to experience different kinds of losses. A conventional repayment plan incurs losses from defaults or from losses in cash flow due to late payments—either of which may be attributable to willful non-payment or to errors in servicing and collection. Both default and arrearage can be expected to increase with financial hardship—as in periods of unemployment—although sensitive provisions for deferment or refinancing can lessen such losses in conventional loan schemes.

Losses from income contingent loans, on the other hand, will mirror the losses from income tax collections generally in the particular country: that is, from non- or under-reporting of income, either earned or unearned, and from overstatement of the expenses purportedly incurred to bring in this income (or of any other kinds of otherwise allowable deductions from an individual’s gross earnings). The problem with income contingent repayment obligations is their essential *non-detectability*. There is no signal,

or trigger, similar to the missing of a scheduled payment on a conventional loan for the underpayment on an income contingent loan due to an underreporting of income. In short, a conventional loan program employing a combination of monthly repayments as well as employer deductions where appropriate, with vigorous enforcement, and with clear repayment expectations at the time of initial borrowing as well as at the time of departure from the university, may stand to recover as much or even more than an income contingent plan.

Income Contingent Loans and the Need for Private Loan Capital

In so far as the impetus behind student loans is the need to shift a portion of the costs of higher education from governments to students, the loans need ultimately to tap *private savings* rather than rely simply on *governmental tax revenue*. Large-scale savings in industrialized countries are found mainly in banks or investment funds, in corporate and insurance company reserves, funded pension plans, and the like as well as in personal savings accounts. These private savings are tapped either by having banks make and hold the loans, or by having the university or the government make the loans, but then to sell the loan notes in “bundles” to the banks or other primary holders of savings. The student loan notes themselves are too risky for private savers without some assurance of ultimate repayment—e.g. collateral from the parents or a guarantee from the government—but with this assurance, the student loan notes can find buyers in the private savings market.

Herein lies another problem with loans of the income contingent variety. Unlike most conventional loans that may be defaulted upon but can then be collected from a guarantor or co-signatory (or collateral seized and sold), an income contingent loan, although fairly well insulated from defaults *per se*, can be recovering little or no repayments due to the low but *misreported* current income of the borrower and still not be detectable as a default, *per se*. The holders of the income contingent loan notes, then, would be unable to collect from any guarantor or co-signatory; indeed, guarantors and co-signatories are generally not associated with income contingent loan schemes. Depending on the nature of the prevailing employment, the health of the economy, the technical ability of government to monitor all incomes, and the culture of compliance with income tax reporting and payment, the risk of under-payment on an income contingent loan may be as common—but considerably more or more difficult to “catch” or “stem”—as defaults and arrears on conventional loan repayments. Thus, loans of the income contingent variety are less likely than conventional *guaranteed* loans to find any private buyers—and therefore to continue their dependence on government/taxpayer for loan capital.¹¹

An Unintended Consequence: Income Contingency and the Shift of Parental to Student Cost Burden

One of the consequences of the form of income contingency that has been adopted in Scotland and is advanced in the 2003 UK White Paper (Department of

¹¹ Even in Australia, which touts its Higher Education Contribution Scheme (HECS) as a success and a model for much of the world, the loans depend entirely on government revenue, and the income contingent loan notes in the hands of the government (that is, *the promises to pay what can be viewed as income tax surcharges*) have virtually no market value (even though these HECS promises could in theory sustain a higher level of governmental indebtedness). This theoretical position, however, has not been supported by the International Monetary Fund.

Education and Skills 2003) is the transfer of cost burden from parents to students. This is because *income contingency* in these cases has been advanced not as a way simply for the students to repay an indebtedness already deemed by policy to belong appropriately to the student, but as a means of shifting that cost burden currently borne by many parents in the form of the relatively small, means-tested tuition fee to an additional burden borne by students (that is, in addition to what students are already bearing, frequently through student debt, via their assumption of living expenses). For this reason, it is important at this point in our analysis to explore the distinction between the parent's versus the student's respective share of costs of higher education, and their respective roles in any considered policy shift from the government, or taxpayer, to either or both the parent and student.

Cost-sharing is frequently advanced as though the student's and the parent's (or family's) shares were theoretically and practically indistinguishable. This can be true in some instances. Policy assumptions can be made that parents with certain profiles of income, assets, purported special hardships, and other dependent children still in school can afford to contribute so much to the costs of their children's higher education and that students ought to be able to earn so much during their years at the university and then be able to bear so much higher educational indebtedness to be repaid after graduation. In practice, however, some students may wish to be financially independent even though their parents could and would contribute; or some parents may decide not to contribute up to the expected amount. In either case, the children will need to earn more and/or assume more indebtedness in order to replace the now-missing expected parental contribution. Or, students may assume higher educational indebtedness according to plan, but it may be the parents who in fact make the repayments, further complicating whether the non-governmental share is being assumed by the student or the parent.

However, the theoretical rationales underlying the expectation of a parental (or perhaps an *extended family*) share and a student share are quite different. A parental contribution is based on the principle that the student is still, at least through his or her first degree (assuming no significant time lapse between the completion of secondary and the beginning of tertiary education) a *financially dependent child* and that parents have an obligation to contribute financially to the expenses associated with their children's higher educations, at *least to the limit of their financial ability*. (Additionally, it is assumed that the parents derive considerable satisfaction from the higher education of their children, and derive more satisfaction--and even some derived status--from being able to place their children in the "best" university they can afford and that their children are able to get into.)

In countries that have tuition fees, this parental obligation, or *expected parental contribution*, generally extends both to the underlying costs of instruction (i.e. tuition fees) as well as to food, lodging, and other the expenses of student living. Where there is an extensive, tuition-dependent private sector and where the public sector also charges more-than-nominal tuition fees, the expected parental contributions can be very high indeed.¹² To the extent that the parents are financially able, these contributions are

¹² US parents, for example, can expect to pay \$10,000 or more for their child to attend a public college or university and \$25,000 or more for an expensive private college, in both cases including tuition fees as well

expected to be borne at least through the baccalaureate, and the family may be expected even to draw on savings or other assets and in some instances to borrow from future income.

In order to uphold the principle of higher educational opportunity, or widespread accessibility—a principle officially embraced by virtually all countries—the notion of an officially-expected parental contribution requires some measure of parental *means* or *need* so that financial assistance or some kind of offset to tuition fees can be granted. This requires some way to assess and be able to verify the parent’s professed means, or need. In most of the OECD countries, especially those that rely heavily on income taxes and have thus constructed elaborate systems of determining and verifying income from all sources (both *earned* from wages, salaries, commissions, and the like, and *unearned* from dividends, interest, and rents), parental means can be reasonably inferred from whatever income has been determined to be appropriately taxable.¹³

The expectation of a parental contribution towards the expenses of higher education raises a number of other complications and questions: for example, the degree of sacrifice to be expected, whether to consider assets such as the family home in the calculation of *ability to contribute*, whether to expect the parents to have made any effort to have *saved* for their children's higher education, or whether reasonably to expect some additional parental indebtedness. Officially-expected parental contribution become complicated in instances of parental separation or divorce or disputed custodianship of the children. Also, there is a question about where to draw the line between financial responsibilities for the first, and for subsequent advanced, degrees. But the most complicating factor of all may be the very appropriateness of the expected parental contribution itself: that is, the assumption underlying an officially expected parental contribution that the student is still, at least while enrolled full-time through a first degree, a financially dependent child.

The validity or applicability of this assumption—that is, whether the university student is properly viewed as a financially dependent child or an independent adult—is largely cultural, but is also a function of the extent of higher educational participation in the particular country as well as the ability and willingness of that government to tax, both extensively and progressively. US parents, for example, expect to pay at least through the baccalaureate (to the extent they are financially able) and are even expected to draw on savings, or assets, and in some instances to borrow from future income. South and East Asian parents seem to expect to contribute and to sacrifice financially to do so. German parents are obligated by law, up to their officially-calculated means, to contribute to their children’s costs of food and lodging (there are still no tuition fees), and they can be taken to court for the failure to do so. British parents, according to Barr (from

as student living expenses—and also in both cases *in addition to* the \$5000 to \$10,000 share that may be expected to be born by the student through loans and part-time employment.

¹³ In countries with neither highly developed systems nor a culture of tax compliance—and this includes most if not all developing and transitional countries—the determination of parental or family means and thus of the financial assistance required for a student to access higher education is extremely difficult and subject to both error and misrepresentation. In such cases, approximations to, or proxies for, *means* such as parental occupation, or the educational level of one or both of the parents, or verifiable ownership of an automobile or of a home with plumbing, may have to be employed. See McMahon (1988), Tekleselassie (2001) and Wolanin (2002).

studies in the early 80s and reportedly corroborated in the early 1990s) frequently do not meet the full *officially expected parental contribution*, leaving students both "...in poverty" and "...in a dependent position" and leading Barr to conclude that a proper UK system should eliminate "up front" fees and the notion of an expected parental contribution altogether (Barr, 2001 p. 205).

In contrast, Scandinavian culture views the student as an *independent adult*, and there is no official parental contribution either toward the costs of instruction (there are no tuition fees) or toward the costs of student living, which are deemed to be the responsibility of the students themselves (although many observers believe that many Scandinavian parents in fact do contribute). But the Scandinavian countries are also blessed with high per-capita incomes and very successful and progressive tax systems. Scandinavian parents understandably believe themselves to have already paid for their children's university education—and the families that are most likely to send children on to higher education have almost certainly paid substantially more taxes than those who are not. In addition, Scandinavian countries have effective and ubiquitous student loan schemes that impose considerable cost sharing on students in the form of student financial responsibility for virtually all of the costs of student living. Thus, a combination of wealth, relatively flat demographics (providing for high but relatively stable participation rates), a very progressive and technically successful tax system, and extensive and generally available student loans allow the Scandinavian countries to forego an officially expected parental contribution towards either the costs of instruction or the costs of student living.

The theory behind the appropriateness of a *student* contribution, on the other hand, is based almost entirely on the assumption of substantial personal and private benefits from the higher education. These presumed benefits may be manifested in higher lifetime earnings, greater status and influence, more "life options," or simply the personal satisfaction that comes (to most people) from being better educated. This theoretical appropriateness of a *student* contribution is buttressed by the fact that higher education in almost all countries (including developing and transitional countries) tends to be partaken of disproportionately by an intellectual and social elite—further supporting the principle that students should contribute something toward the costs of their higher education. It is this principle--quite apart from the principles that supported the parental contribution--that calls for student loan programs so that student can defer this contribution until they are financially able to do so. However, the increasing interest in the UK and elsewhere in adopting an Australian-type scheme in lieu of a tuition fee will have the effect of shifting what has been a financially successful (if controversial) *parental* contribution to an *additional student* contribution toward the costs of higher education.

Income Contingent Loans and Equity

The other major aim of student loan programs—to some degree working against the goal of shifting the expense burden from the taxpayer to the student—is to maintain and even enhance equity or access to higher educational opportunities. Taken by itself—that is, without any *additional* cost-sharing, or further shift of cost burden to parents and/or students—the ability to borrow, at a reasonable rate and possibly with little or no collateral, provides a way for some students, particularly those from poor families, or those who by any system or tradition have outgrown their financial dependence on their

parents and who thus may have no other resources, to be able still to invest in their own higher education. In addition, student loans as a component of cost-sharing, designed to provide additional revenues to higher education, provide a way to expand revenues, therefore to expand capacity, and therefore to expand the participation of those for whom the access barrier is as likely to be insufficient higher educational capacity as it is to be insufficient personal or parental resources.

It is true that students would prefer no tuition to even some tuition and would prefer grants to loans. It may also be the case that there are some populations (perhaps rural, or ethnic or linguistic minorities) who are more debt-averse and reluctant to borrow, and who would, in the short run, abandon altogether higher educational aspirations for themselves or for their children if borrowing is the price of getting a higher education. On the other hand, the claim of widespread debt aversion may also be a self-serving assertion by students who will not lose their presumed entitlements without a struggle. In the end, since the consequences of insufficient higher educational revenue and therefore of insufficient higher educational capacity tend inevitably to fall disproportionately on the poor, who have no private or "out-of-country" alternatives, it is more likely in fact to be the poor who most need the loans, both for higher educational capacity to be increased and for a way to make an investment in their own future.

The question that is relevant to this inquiry, then, is whether a particular *form* of student lending--specifically a conventional loan with a known cost (i.e. a simple annual interest rate) and a fixed repayment schedule or an income contingent loan with a fixed percent of income owed, but an indeterminate cost and repayment period--provides more access. Posed another way, this question asks whether one or another form of student indebtedness makes students more (or less) willing to go into debt in order to attend a college or university that he or she would have been unable to attend in the absence of that opportunity to borrow? Some subtly different forms of nearly the same question include: Which form of student loan repayment obligation would the student prefer *at the onset of the need to borrow* (when, as in the US, an income contingent repayment mode might be available as an option)? Or, which form would the student prefer *when actually making the repayments*? Or finally, under which form of repayment obligation would the student be better off *after full repayment*?

These loan preference questions are exceedingly difficult to answer even in theory, and quite impossible to answer experimentally or through actual observation, as there have been so few occasions where there have been two different but fiscally comparable plans in operation long enough to see which one seems to make a difference in accessibility. In fact, the US Direct Loan Program provides the only generally available student loan program in the world where borrowers have a choice between an income contingent, a conventional mortgage-type, and a fixed-but-graduated repayment mode—each with precisely the same present value of anticipated repayments. In this contest, the income contingent option has not been the favored choice (General Accounting Office, 2001).

In fairness to the proponents of income contingency, the US income contingent option is also extremely complicated, notoriously ungenerous to low-earning borrowers, and lacks the convenience of being "piggybacked" onto the US income tax and social security withholding systems at the point of wage and salary payment, and so fails on all

counts to provide the kind of loan that the proponents of income contingency have always advocated. The US income contingent option has been purposely constructed to maximize the recovery of repayments, minimize the need for governmental subsidization (at least beyond that called for by the conventional student loan plans), and not provide any further burden to employers or jeopardize the very high US voluntary income tax compliance. On the other hand, another reason for the relative lack of interest in the US income contingent repayment option may be that the US conventional student loan schemes currently (as of 2003) provide such easy and almost automatic *deferral* in the event of a return to school as well as *relief* and *refinancing* in the event of unemployment or other occasions of genuine financial hardship that the flexibility and manageability once thought to be the special property of income contingency seems now to have been built into US conventional loan programs (US Department of Education, 2003).

Income Contingent Loans and Political Expediency

At the same time, even if income contingent loans are neither *ipso facto* less costly or burdensome, nor even necessarily more manageable, they may still be more *politically saleable than loans of a conventional variety*—and thus, in the end, more likely to allow the introduction of cost sharing into a country where there is extraordinary resistance to the very concept of either students or parents bearing a significant portion of the costs of higher education. This is a purely political—almost a *public relations*—case for income contingency. The Australian Higher Education Contribution Scheme (HECS), for example, has been undeniably successful in expanding the revenue to higher education. It can also be said that it has done so in a way that obscures the fact that it is the *introduction of tuition fees*—far more than the introduction of any particular means of handling the resulting student loan obligation—that accounts for the increased flow of revenue to Australian public higher education. The increased revenue still comes in the first instance entirely from the government. But the government is presumably more generous to the Australian universities because of the two forms of enhanced revenue offsets within HECS: (1) the increased non-governmental revenue from the parents who pay tuition up front to lessen their children’s HECS obligations, and (2) the increased governmental borrowing capacity that is at least in theory covered by the government’s new assets in the form of the signed HECS future “surtax” obligations.

In the case of Scotland, most students and most of the political left were apparently made happy by the conversion of what was a relatively modest, means-tested and largely parent-borne *tuition fee* to an *entirely student-borne income contingent loan*--for some reason preferring the additional burden on students (cleverly termed a “contribution to the Scottish University Endowment Fund”) to the Britain’s politically unpopular tuition fee. And the 2003 UK White Paper, *The Future of Higher Education*, is promising the same thing for England: that is, the conversion of what has been an avowed and continuingly controversial (however modest and means-tested) tuition fee to a mandatory student-borne income contingent loan—on top of loans that the students are already bearing for their living costs.

Some academics and policy analysts may be made uncomfortable by what might be viewed as *misrepresentation*--represented, for example, by calling a mandatory contribution from students and/or parents to cover a portion of instructional costs anything but what it is: *a tuition fee*. Furthermore, students who are made to believe that

their income contingent obligations are fundamentally unlike real debts may borrow more than they need to, or even mean to. Similarly, politicians may erroneously believe (or be encouraged to pretend that they believe) that they have solved a serious higher education revenue problem when of course they have not—to the fiscal jeopardy of the public universities and possibly as well to the students.

On the other hand, if the ideological and political opposition to tuition fees and other elements of cost-sharing is so extreme—and the need for other-than-governmental revenues is so great--then perhaps the introduction of tuition fees and student loans under the cover of an *income contingent contribution* is worth the price of just a little misrepresentation.

In summary, Income contingent loans modeled after the Australian Higher Education Contribution Scheme (HECS) would seem to work well when:

- A government, by downplaying (or not mentioning at all) the politically treacherous concept of *tuition fees* is able to get an element of cost sharing that it would likely be politically unable to get were it to advocate openly even a modest tuition fee.
- A government, in stressing mainly the income contingent loan obligation of the student *in lieu of a tuition fee*, is willing to forego the potential of more *up front* tuition and to minimize the role of parents (even affluent ones) as an important partner in sharing the costs of higher education.
- A government does not really need even the students' deferred revenue *now*, but is able to tax and/or borrow sufficiently to keep the public universities academically strong and accessible, and is willing and able as well to be the true lender for the student loan scheme.
- The majority of student borrowers (or students who become obligated to future income contingent payments) will have during most years of their working lives a single employer at a time, which will pay them a periodic and relatively regular salary, and which will also be sufficiently large, sophisticated, and legally compliant that it can be counted upon to take out of the borrower's paycheck the correct amount owed for student loan repayment, year in and year out.

Conversely, HECS-type income contingent loans are less applicable when:

- The need is for non-governmental revenue *now*, making the parental contribution to tuition (even with a great deal of discounting) the primary source of needed revenue supplementation.
- The scarcity of governmental revenue precludes government from being the sole lender (which places a premium on student loans that have some--albeit discounted--value on the private capital market).
- Many of the graduates (borrowers) are likely to hold multiple short-term jobs and to be employed in the informal economic sector where records are most unreliable--or to emigrate.

- There is no tradition of voluntary, reliable self-reporting of incomes, and the state systems for monitoring and verifying incomes for the purpose of income tax withholding and/or pension or social security contributions are non-existent or unreliable.

Summary

Cost-sharing, or the shift of increasing portions of the costs of higher education from governments and taxpayers to parents and students is, early in the 21st century, pervasive and expanding even as it remains controversial. Within this policy shift, student loans, also controversial, seem destined to play an important and increasing role. And among the very many forms of student loans, the form employed by Australia in its Higher Education Contribution Scheme, together with other variations of so-called income contingent loans, are receiving increasing attention from politicians and policy makers.

The Australian scheme appears to have been successful, and there are many reasons to favor elements of student loan programs that incorporate features associated with income contingency generally. At the same time, income contingent loans, especially as identified with the Australian HECS, seem also immersed in misunderstanding, misrepresentation, and unintended consequences. Student loans are important, both to the financial viability of higher educational institutions, to the accessibility of these institutions to students without regard to the income or other background characteristics of their families. But student loans are also more complicated than often portrayed. Countries contemplating the adoption of loans, or of larger financial schemes that incorporate the deferment of a student contribution, should study carefully both the theoretical underpinnings of cost sharing and the actual operations of alternative programs of tuition fees and student loans.

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