

The Applicability of Income Contingent Loans in Developing and Transitional Countries

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An increasingly important question in the construction of national student financial assistance policies, particularly in developing and transitional countries, is the applicability of *income contingent loans* for recovery of a portion of the costs of higher education. Such student loan programs, especially promoted by Australians and “on the table” in 2003 for adoption in Britain, have long captured the fascination of both economists and politicians. As provided in Australia, New Zealand, Sweden, Scotland, and South Africa and as recommended in much of the higher educational policy literature, income contingent loans (sometimes mistakenly referred to as “graduate taxes”) have certain theoretical as well as practical advantages.

However, many of these claimed or presumed advantages are not in fact the property of *income contingency* per se, but of the extent and type of built-in governmental subsidization or of the use of the government’s machinery of income tax withholding and pension contributions, most of which can be extended to conventional, mortgage-type loans as well. Thus, although income contingent loans are often sold as fundamentally unlike loans, they are, in fact, fundamentally *just like loans*: to be repaid—at least for most borrowers—with interest and carrying only as much protection, or subsidization, for the eventual *low lifetime earner* as the government chooses to build into the terms of the contract. At the same time, the collection of income contingent loans depends totally on the lender’s (in almost all cases, meaning the government’s) ability to track and to verify all sources of income for all borrowers for most of their earning lifetimes—which is exceedingly difficult and perhaps a practical impossibility at this time in most developing and transitional countries.

Furthermore, income contingent loans are frequently advanced (especially by their proponents in Australia and the UK) not simply as a way for students to pay whatever portions of the underlying costs of instruction (i.e. tuition fees) or costs of student living (i.e. fees for food and lodging) may have been determined to be their proper share, but as an alternative to the so-called *up front* payment of tuition fees—which in most cases are deemed to be the parent’s share (at least for those financially able to pay). Implemented as an *alternative* to tuition fees, the effect of an income-contingent deferred contribution, then, is to shift radically the very meaning of *cost-sharing* from a financial responsibility to be paid by both parents and students to a financial burden to be paid only by students (or by taxpayers to the extent that the loans are not actually meant

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to be repaid). The thesis of this paper is that the great need in both the developing and the so-called transitional countries for successful schemes of cost-sharing is not likely to be met by student loan schemes that: (a) have little likelihood of being repaid at anywhere near the true cost of capital; and (b) are advanced as alternatives to up-front tuition fees, thereby foregoing a parental contribution altogether for most parents.

Student Loans, Cost-Sharing, and the Imperative of Cost Recovery

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 forms of lending--in all countries purport to achieve two distinct and basically contradictory aims. In the first place, such schemes are usually part of a policy of *cost-sharing*, or the shift of a portion of the costs of higher education from governments, or taxpayers, to parents and/or students. Second, loan schemes are ways to enhance participation, or higher educational accessibility, 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.

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. However, the most compelling case for cost-sharing in both developing and transitional 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 enormous scarcity of tax revenues and the long and compelling queue of competing public needs, both of which conditions are especially characteristic of both the developing and the transitional worlds. Simply put, the economic, political, and social imperatives for a great expansion in the capacity of tertiary education systems--especially in countries that currently have small portions of young adults enrolling in any sort of post-compulsory studies--is so far in excess of any conceivable additional public revenue likely to be devoted to higher education that alternative, non-governmental revenue sources absolutely must be found. 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 as well as fees for some of the currently free or heavily subsidized student housing and food.

Cost-sharing is frequently advanced as though the student's and the parent's (or family's) shares were theoretically and practically indistinguishable. 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.

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. And it is the increasing popularity of the *income contingent* form of student loans that is having in some countries the (presumably unintended) effect of also shifting what might be an expected *parental* contribution to an *additional student* contribution toward the costs of higher education.

Forms of Student Loans

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

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 loan, on the other hand, 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 is generally either repayment at a contractual rate of interest or repayment for a maximum repayment period or until a maximum age). The elements 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 in which the stipulated elements are (1) the required monthly or annual payments; (2) the rate of interest (either fixed or variable); and (3) the repayment period—which together stipulate the cost of the loan to the borrower. The element that varies in the conventional, or mortgage-type, loan is the *burden of repayments*, or the relationship of repayments to current earnings.

The Presumed Superiority of Student Loans of the Income Contingent Form.

Proponents of income contingent loans frequently proclaim income contingent loans to be *ipso facto* superior to all other forms of student lending. For example, income contingent loans are often portrayed as less costly to those borrowers who turn out to earn lower incomes. However, although the income contingent repayment form does have attractive features, it is well to keep in mind—especially in reference to the applicability of the income contingent loan form to developing and transitional countries—four qualifications, or caveats, to the common presumption of the superiority of the income contingent loan form.

First, 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 alternatively, by the discounted present value of the reasonable anticipated repayment stream. On the other hand, if "manageability" is defined by the *ease of the repayments*, then manageability can always be enhanced by reducing the individual repayments (for a conventional loan) or by lowering the percent of income to be repaid (for an income contingent loan)--in either case, however, extending the repayment period and the total dollars that will ultimately be repaid, but not in itself affecting the true cost of the loan (that is, the discounted present value of the eventual repayment stream).

Second, as stressed above, an income contingent loan ought not to be viewed as a *substitute for a tuition fee*, but rather as simply another way of *deferring it* (or deferring any other necessary expense of higher educational attendance). If a student incurs a payment obligation for attending an institution of higher education that can be paid in the future--*income contingently or otherwise*--then for all practical purposes there is an effective tuition fee. In some cases, as in the US, it is assumed that parents (or perhaps students) pay the tuition "up front," but may take out either a parent or a student loan to do so (which, in the case of a US Direct Student Loan, may be converted at the initiation of the repayment process to an income contingent repayment schedule). In other countries, the "loan" passes directly from the lender (generally the government) to the university (or into the university's budget appropriation) without ever passing through the

student's hands, and perhaps never even being perceived quite like the combination of *tuition fees* and *student loans* that such a policy really presents. In still other cases—Australia being a good example—the student and the parent are given the choice of accepting the terms of the income contingent loan (which goes directly to the university) or paying “up front” at a considerable discount. However, a cost-sharing obligation that is totally in the form of an income contingent loan and that is presented (or allowed to be perceived) as *in lieu of tuition* (without a strong incentive to pay “up-front) discourages and may all but preclude a parental contribution to the costs of instruction, thus effectively shifting the higher educational cost burden only to the student.

Third, 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. This observation in of itself does not deny the theoretical attractiveness of these provisions, nor deny certain other theoretical attractions of income contingency: it merely observes that if the government can compel employers to collect income contingent loans or graduate taxes, it can also compel employers to collect any payment owed by citizens, the effective collection of which is deemed to be of overriding public importance: local taxes, for example, or child support, or the cost of automobile insurance. (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 its citizens can hardly be expected to be able to collect payments on an income contingent loan or graduate tax obligation.)

Finally, an income contingent loan presents major complications not found with conventional “mortgage-type” loans. Most of these arise from the need to stipulate 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. Highly industrialized 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 developing countries or transitional countries, where sources of income of 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.

It is true that repayments on conventional student loans are also problematic and that most loan programs in most developing and transitional countries have been plagued with very low recovery rates. In keeping with the point immediately above, however, if any of these countries had the kind of ubiquitous and generally successful income tax or

pension contribution machinery necessary to implement successfully an income contingent loan program, then the same governmental collection procedures could be mandated for the conventional, fixed repayment loan. At that point—i.e. with employers collecting repayments for either form of student loan along with income taxes and pension or insurance contributions—the difference between an income contingent and a conventional, fixed-schedule loan is that an underpayment with the conventional loan is instantly and unequivocally known and can be dealt with; underpayments on income contingent loans can extend for years and be virtually undetectable.

The Contribution of Income Contingent or Conventional Loans to Revenue Supplementation

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 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. It is well to note at the outset that the cost recovery experience of loan programs in low-income countries has been generally dismal. However, the question being addressed in this paper 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—which in turn may be attributable to willful non-payment, to errors in collection (simply losing track of borrowers), or to losses from borrowers who are experiencing financial hardship, as with periods of unemployment. Losses from income contingent loans, on the other hand, will mirror the losses from income tax collections in that country generally: 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).

Of these losses anticipatable in transitional and developing countries, the loss from the income contingent repayment streams is arguably apt to be greater—if for no other reason than because of its essential *non-detectability*, as discussed in the preceding section. And in those occasions where a conventional loan contract has a co-signatory (typical of student loans in most transitional and developing countries) and where employer withholding possibilities cover only some of the potential borrowers and only some of their incomes, a conventional loan program, employing both monthly, or coupon

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, probably stands to recover as much and probably more of the anticipated repayments than an income contingent plan.

The Need for Private Loan Capital

A slightly different criterion of *success*, but still related to the aim of effective cost recovery and the need to supplement government revenue, is the degree to which the student loan plan can tap private savings rather than rely simply on governmental revenue. Particularly if the purpose of cost-sharing—that is, the imposition of tuition or of charges for room and board formerly provided by the state or the university—is to add revenue that the government (or taxpayers) cannot or almost certainly will not devote to higher education, then it helps relatively little if the loans must still be financed entirely from scarce governmental revenue.

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 current income (at least the low *reported* current income) of the borrower and still not be in default and thus be unable to trigger any guarantee or collateral repossession. Especially in developing countries, where many university graduate borrowers will have several income streams, *some of which will almost certainly go unreported and most of which will be unverifiable*, the risk of under-payment is great and arguably as or more difficult to "catch" or "stem" as defaults and arrears on conventional loan repayments. 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 assets in the hands of the government (that is, *the promises to pay an income tax surcharge*) have virtually no market value.¹ In Australia, which is relatively able to tax, which will probably collect a reasonable portion of the income contingent payments owed, and which can run deficits without unleashing destructive inflation, this may be of little consequence. In transitional and developing countries, which tend to have limited private savings, a limited capacity to tax, and therefore a limited governmental capacity to borrow, an income contingent loan plan financed by the government would more nearly resemble the mere printing of money, with all of the negative consequences of "taxation by inflation."

Income Contingent or Conventional Loans and the Expansion of Participation

The other major aim of student loan programs—to some degree working against the goal of shifting the expense burden from the taxpayer² to the student—is to maintain,

¹ Following the observation in the preceding note, the Australian government, with the HECS obligations considered as assets on its balance sheet, could in theory sustain a higher level of indebtedness than it could in the absence of these obligations. This theoretical position, however, is not supported by the IMF or most other international monetary agreements.

² 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

or even to enhance, *access to higher educational opportunities*. Taken by themselves—that is, without any accompanying additional cost-sharing, or 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 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.

An important question, 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 option might be available)? 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 and access 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

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.

between an income contingent, a conventional mortgage-type, and a fixed-but-graduated repayment—each with precisely the same present value of anticipated repayments. In this contest, the income contingent option has not been the favored choice among US students.

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 loans provide such easy and almost automatic *deferment* 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.

Summary: Income Contingent Versus Conventional Student Loans

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

- The 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.
- The government in stressing mainly the income contingent loan obligation of the student, is willing to forego the potential of more *up front* tuition—and thus to minimize the role of parents (even affluent ones) as an important current partner in sharing the costs of higher education.
- The Government does not really need even the students' deferred revenue *now*, but is able to tax or borrow sufficiently to keep the universities open and the students fed and housed, and to accept payment only in the future--in essence *becoming the lender*.
- The majority of student borrowers (or students who become obligated to future income contingent payments) will have a single employer, which will pay them a periodic and relatively regular salary, and which is also sufficiently large, sophisticated, and legally compliant that it can be counted upon to take out of the borrower's paycheck the correct amount, year in and year out.

Conversely, HESC-type income contingent loans would seem to be 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).
- Graduates (borrowers) are likely to hold multiple short-term jobs, to be employed in the informal economic sector, where records are most unreliable, or to be emigrating.
- There is no tradition of voluntary, reliable self-reporting of incomes, and 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.

The Applicability of a HECS-type Income contingent Loan Plan for Transitional and Developing Countries.

From the analysis above, the applicability of a HECS-type income contingent loan plan for transitional and developing countries can be summarized in the following points:

1. An income contingent loan scheme that is to be collected along with the government's income tax withholding and pension contribution mechanisms will almost certainly not provide significant cost recovery in most transitional and developing countries for the simple reason that most do not (at least not in the year 2003) have effective and reliable systems for such collection at the point of wage and salary payments. In the absence of such ubiquitous systems, governments are likely to know the incomes of, and be able to collect from, mainly the civil servants and perhaps those employed by multinational corporations and some large private enterprises. However, repayments are likely to be low or missing altogether from those employed in first or second jobs in the private sector, many or most of those who are self-employed, and virtually all émigrés (a significant proportion of the university graduates of many transitional and developing countries).
2. The negative consequences of limiting most of the repayments to civil servants or to those only in very large and visible private enterprises include not only the lost revenue but also the inequity, the market distortions, and the seeming governmental complicity in a program in which only *some* debts actually have to be collected. Especially regressive is the notion that successful entrepreneurs and émigrés might be "missed," while the relatively poorly paid civil service would be forced to repay a loan (and thus to pay a tuition fee) that others are able to avoid.³
3. Even if these distortions did not occur, or could be surmounted, income contingent loan obligations still have little or no value on the market—that is, little or no ability

³ In fairness, collecting from émigrés is a problem for any student loan program. However, having the predominate--or even the only--serious collection effort carried out as an adjunct to the government's income tax withholding or pension contribution schemes seems almost to absolve the obligation of the émigrés.

to tap private savings. Therefore, if the income contingent loans are to provide *additional* revenue—for the purpose either to expand higher educational capacity, or to enhance higher educational quality, or to put money into the hands of students who would otherwise be excluded from higher education altogether—the additional revenue will still have to come from government. But the principal rationale for cost-sharing, or revenue supplementation, in the first place (which is what student loans represent) is to provide *non-governmental* revenue because additional revenue for higher education from the taxpayers is thought to be so unlikely. Cost-sharing in the form of income contingent loan obligations held by the government is better than no cost sharing at all. But this form will not solve higher education's immediate revenue problems because it does not provide significant amounts of new money.

4. Finally, the “downplaying” (or even the outright rejection) of *up front tuition* in favor of a supposedly painless alternative (i.e. the income contingent obligation) excludes, or at least minimizes, the participation of parents in the badly needed cost-sharing. Allowing, and substantially subsidizing, an “up front” option, as in the Australian HECS program, recognizes the need for some immediate payment and effectively rejects the accompanying call from some quarters for the abolition of “up front” tuition fees. However, those who would reap the generous current (as of summer 2003) 25 percent discount for *up front* payment are, of course, only those more affluent parents who can afford to do so.⁴ Finally, even if the “prepayment option” effectively works like an “up front tuition” for some families, it fails to reinforce the general principal of an expected parental contribution to the costs of higher education. Rather, the “up front” payments are made only under the guise of being able to help some children reduce some of their relatively light debt burdens--which is not the same as declaring there to be a universal parental obligation to share in the costs of higher education to the extent of the family's financial ability.

The above assertions suggest that an Australian *HECS-type* income contingent loan plan will not provide a significant alternative non-governmental revenue stream to the universities and other tertiary-level institutions in either transitional or developing countries, nor is it likely to enhance participation.

Recommendations for Student Loan Programs in Transitional and Developing countries

1. Universities and other tertiary level institutions in transitional and developing countries need to supplement their limited governmental, or taxpayer, revenues with cost-sharing from both parents and students (This recommendation applies as well to all countries in the OECD and elsewhere in the highly industrialized world; it simply applies more so to the transitional and developing countries where tuition fees are even more resisted, but the need for them is even greater.)
2. This cost-sharing should begin with parents and/or students taking financially responsibility for most of the expenses of student living, but should also include

⁴ Turning this HECS provision “on its head,” Australia can be said to have created a modest up-front tuition, which students and families may, if financially unable to pay, discharge with a modestly subsidized income contingent loan, *but at a 25 percent penalty*.

financial responsibility for a portion of the costs of instruction (that is, in the form of tuition fees).

3. Tuition fees should be established only after policies are in place for programs of means-tested financial assistance as well as generally available student loans.
4. The setting of tuition fees should be as depoliticized as possible. Countries should consider an independent (albeit politically accountable) board, buffered from both the government and the universities and other tertiary institutions, to establish the base year tuition fee[s] and also to establish annual increases thereof.
5. A single-track up-front tuition fee--albeit one that can vary by institution and/or by program--is preferable to a dual track system that varies by the academic preparedness (and thus inevitably by the region, social class, ethnicity, or family language) of the entering students.
6. Politically-acceptable language and euphemisms for "tuition fees" such as "contributions" may be necessary, but should not have the effect of substituting a larger (albeit deferred) contribution from students for an up-front contribution expected from parents (to the limit of their financial abilities to pay). In short, an expected student contribution via a student loan program (income contingent or otherwise) is probably a good step, and it may be a way to accommodate an up-front tuition for some students. But it should not be adopted as a wholesale substitute for an up-front tuition to be collected wherever possible from parents or extended families.
7. Solutions to the acute and worsening austerity experienced by universities and other tertiary-level institutions in the transitional and developing worlds must not be (nor even appear to be) only at the expense of students and parents—that is, only via the introduction or acceleration of tuition fees. Rather, universities and other institutions must actively and transparently seek efficiencies (even at some considerable disaccommodation and pain) that minimize the per-student costs of instruction without jeopardizing quality.
8. A student loan program should be designed to collect reasonably close to the amount that was lent, with expected repayments discounted approximately at the government's borrowing rate. In other words, student loans should be only *minimally subsidized*, with interest rates either, at a minimum, pegged to the prevailing rate of inflation or at a maximum to the government's borrowing rate. (This provision is not meant to cover the losses from defaults or from other limited and purposefully designed subsidies or repayment forgiveness features.)
9. The student loan program must be equipped with legal authority to collect, technology to maintain accurate records, collectors who can track borrowers and verify financial conditions, advisors and repayment counselors in the universities, and the legal authority to enlist at least the larger employers in the collection of repayments.
10. An income contingent repayment mode should *not* be installed as the expected, or "default," repayment mode for all borrowers, but should be an option for borrowers at the start of their repayments and the beginning of their post-graduate employment, who can demonstrate that they can probably discharge the repayments by paying a

percentage of earnings from a single employer that represents the dominant earnings stream. (In short, repayment via income contingent payroll deductions should not be an option for the unemployed, self-employed, or only “marginally-employed. Rather, their needs for either forgiveness or refinancing should be handled in other ways.)

11. Procedures need to be added to the repayment processes for conventional, fixed-schedule student loans, to accommodate borrowers whose earnings are low or for whatever other reason are experiencing real repayment hardships, either temporarily or permanently. (In short, a conventional loan needs the same kind of genuine *low earnings protection* that is presumed to follow by definition from an income contingent form of repayment obligation.)
12. Other procedures to be attached to student loans in most transitional and/or developing countries should include:
 - a. Repayment terms sufficiently long for the monthly payments to be manageable for most borrowers.
 - b. a requirement of a parental or other family co-signatory, even where there is little or no real assignable family collateral, and even where the co-signatory adds little to the private market value of the loan. (The purpose of the parental or family co-signatory would in part to give the government an additional means of collecting in the event of default, but also in part simply to enlist the help of the family in impressing on the borrowing children that loans are real obligations.)
 - c. A government guarantee backing up the guarantees of the co-signatories (especially to cover those parents with low incomes and assets).
 - d. A policy of passport controls on émigrés or students seeking advanced degrees out of country requiring a renewed contract (and possibly new collateral or co-signatories) for those leaving the country with student debts.

These recommendations are not, in their essential features, significantly different from other recommendations, even those that feature income contingency. The primary difference is that these recommendations reserve income contingency as an option to be selected at the start of repayments and at the start of the primary post graduate employment, and only then for those for those who can demonstrate a reasonable chance of repayment via the payroll deductions. These recommendations also do not feature student loans—income contingent or conventional—as an alternative to tuition fees, but as a means for the student to repay the share that has, by country policy, been “assigned” to the student, to be repaid either via part-time employment and earnings, or by loans, or by additional family or “other” contributions.

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