Higher Education Financing in a Time of International Crisis: The Australian Exception

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Abstract

The student loan systems of most countries have recently been in crisis. Many former students are confronted with insurmountable repayment difficulties, which for many results in default and can ruin their personal financial future. The situation became very visible during the COVID-19 pandemic. It exposed the key role of insurance against repayment hardship and default, essential to income-contingent student loan systems (ICL), such as that used in Australia.

There is little doubt that most countries' student loan systems are currently in crisis or at minimum face significant difficulties. Substantial problems in higher education financing arrangements have been exposed through the short-term dysfunction of labor markets due to business lockdowns associated with COVID-19 pandemic. The reasons for this issue are now clarified at least for Australia, one of a few countries where student loans have managed to be trauma-free from the economic side of the pandemic.

The key point is that the Australian student loan system, which was initiated in 1989, was the first national higher education financing arrangement to collect student debts on a repayment basis contingent on future personal income. This feature was motivated by the perceived need for insurance for debtors against unexpected, yet inevitable, exigencies associated with unforeseen adverse graduate labor market conditions, to ensure that borrowing risks are substantially mitigated in the process of higher education financing. It has become clear that this is a critical positive feature of the Australian model, which was later adopted in full in New Zealand (1991), the United Kingdom (1998), and Hungary (2002), partially put in place in the United States, Japan, South Korea, Thailand, and Colombia, and currently under very close consideration in many other jurisdictions.

Understanding Why a Particular Form of Student Loans Protects Borrowers

It is critical to understand that there are two quite distinct approaches to student loans, and these are defined by the rules determining loan repayments. The most common approach internationally is known as "time-based repayment loans" (TBRL), in which, like a mortgage, a set stream of repayments is required over a given time period (such as 10 years for Stafford loans widely used in the United States or eight years for the FIES loan system in Brazil).

The other approach, which has been quietly transforming international higher education financing policy over three decades, is known as an "income-contingent loan" (ICL), in which repayments depend solely on the borrower's future income. The essential difference between the two types of loan systems is that ICLs protect borrowers from repayment hardship and default. That is, if an ICL debtor does not have the capacity to repay in a particular period, there are no adverse consequences, such as having to find the money from elsewhere or even defaulting on the loan.

To illustrate how this approach works, note that with the Australian and English ICLs, no loan repayments are required until the debtor's annual income exceeds around AUD 52,000 and GBP 28,000respectively (both around USD 35,000). The collection rate increases as income rises, in much the same way that characterizes progressive income tax collections, and in most countries ICL is accompanied by interest rate subsidies.

Such protection for borrowers is not present with TBRL, which means that debtors struggling to repay debts when their financial circumstances are poor is a commonplace event in many countries. This results in significant proportions of former students defaulting on their loans. Student-loan defaults constitute a very significant problem to borrowers because of the associated damage to credit reputations, which then severely limits individuals' access to normal commercial loans, for example, to purchase a house. Research for the United States suggests that some prospective borrowers resist taking on TBRLs due to the high associated risks expected and adverse consequences of defaults.

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The international student loan comparisons outlined above took on new and much more sinister dimensions with the COVID-19 crisis, in ways that had not been anticipated or understood before the pandemic. Tens of millions of recent graduates in many countries were unable to quickly find employment due to the recessionary consequences of the pandemic. Those former college students with TBRL (e.g., in Brazil, Canada, Chile, Colombia, Brazil, Malaysia, Thailand, and the United States) have experienced major anxiety associated with the incapacity to repay their debts.

The crisis then led to major student loan interventions, most notably President Biden's plan announced in August 2022 to forgive almost USD 5 billion worth of student loans, while other countries implemented extended pauses for the repayment of TBRLs. These interventions are hugely expensive for taxpayers and unnecessary in countries with ICLs like Australia.

Australian Student Loans Experience through the Pandemic and Beyond

Unlike the situation with TBRL, the governments of countries using ICL, such as Australia, Hungary, New Zealand, and the United Kingdom, did not have to take emergency action to protect higher education debtors from the short-term crisis associated with the pandemic. This is because ICL systems have built into them the automatic insurance benefits that shelter those with loans from both repayment hardship and default. Debtors with ICL are not required to repay in periods when they do not have the capacity to do so.

In the late 1980s, when the Australian student loan system was being designed, it was recognized that the ICL insurance advantages had key dimensions with respect to adverse individual circumstances, such as through illness or caring for incapacitated family members. However, it was not foreseen that there are also implicit protective benefits for entire cohorts of borrowers from widespread labor market disruption. COVID-19 pandemic has illuminated this very brightly.

It is important to recognize how important these ICL protections are, and this can be reinforced with reference to the prospects and consequences of a borrower defaulting on student loans. As noted above, defaults impose very significant costs for both borrowers (through their adverse implications for access to further credit) and lenders (since once in default there are few prospects for future loan repayments. Default rates can be extremely high, as much as 40-50 percent of all student borrowers in some countries, and even as high as 20 percent in countries with a relatively high student debt repayment rate, such as the United States. Currently there are over 12 million former college students in the United States who are labelled as defaulters and who thus have very seriously damaged future borrowing prospects.

In Australia there are no student loan defaulters, and thus no debtors with tarnished reputations, because the ICL system automatically provides the protection required to assist those in future financial need. Thus, while the current student loan situation in Australia might need some improvement, as all 35-year-old policies do, in the fundamental area of repayment experience, there is nothing approaching the sorts of crises that are evident and hugely costly in the majority of countries with non-ICL higher education financing arrangements.

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