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The Challenge of Sustaining Student Loans Systems: In Colombia and Chile

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The Chilean government almost fell last year because of student protests against the student-loan system. As a result of the Chilean student-loan crisis, students in Colombia have requested free higher education for all, which would make any kind of student loan irrelevant. Is the end of student loans in Latin America in sight, echoing the growing concern in the United States, where the US$1 trillion student-loan debt figure has been used to denounce student loans as a failed system and approach? In a recent *New York Times* column, Charles Blow described US debt levels as "staggering," and "having long-term implications for our society and our economy, as that debt begins to affect when and if young people start families or enter the housing market" (March 8, 2013). In this context of crisis and apocalyptic statements about student loans in the Americas, the purpose of this discussion is to share, with readers, lessons from recent developments in Chile and Colombia.

THE CASE OF CHILE

What started as a demand by secondary school students was that their free transport pass be extended from 10 months to the entire calendar year. Ironically,

the government rejected that initial demand citing its high budgetary cost but later agreed to a reform package costing 20 times as much as the initial request of the students, which evolved into a full-blown confrontation opposing secondary and university students organizations and the entire government. The leading factions of university students went as far as demanding a constitutional amendment that would guarantee free public, high-quality education for everyone at all levels, including higher education.

To be fair to the students, they had legitimate grievances. For several decades, Chile has had a segregated higher education system, with two groups of universities offering different benefits to students. First, 16 public and the 9 private universities receive government subsidies, whose students are eligible to get generous scholarships and have access to a highly subsidized income-contingent loan system. Second, 36 private universities do not receive public funding but enroll 53 percent of all university-level students in the countries. These students have limited access to scholarships but are eligible for a loan scheme, run by commercial banks with government guarantee, that was established in 2005. The new scheme was very successful in terms of uptake and had a good targeting system. By 2011, 75 percent of all eligible students from the first and second quintiles received a loan. But the scheme started to run into severe difficulties when the first repayments were due, as some graduates found themselves with high-debt levels and a limited repayment capacity because the scheme was not income-contingent. The average debt-service ratio, calculated as the monthly payment over the monthly income, was 18 percent, compared to 4 percent in Australia, 6.4 percent in New Zealand, 2.9 percent in the United Kingdom, and 2.6 percent in the Netherlands. As a result, the default rate quickly

rose to 36 percent, which is extremely high for a young, student-loan program. Not surprisingly, one of the key demands of the protesting students was to abolish the student-loan program became one of the key demands of the protesting students.

A few months ago, the government announced its intention to merge the two existing student-loan schemes, applying the terms and conditions of the first one to the entire system. This means, among other things, that repayments will be income contingent, allowing students to choose their preferred careers and paying for their degree with a fixed share of future income and thereby ensuring a reasonable debt burden. Monthly payments will range from 5 to 15 percent of monthly income, depending on the income level of graduates. Repayments will be collected through the tax system, even though the Ministry of Finance was initially reluctant to involving the administration of student-loan repayments.

THE CASE OF COLOMBIA

Few people in the world are aware that the first ever student loan agency was established in 1951 in Colombia. The Colombian Student Loan Agency—Instituto Colombiano de Credito Educativo (ICETEX)—was the dream of a young and idealistic Colombian, Gabriel Bettencourt, who after benefiting himself from a loan to get his master's degree in the United States, convinced the president of the republic to set up an agency that would provide the same kind of services to all needy Colombians.

After several decades of uneven developments, ICETEX has grown to be one of the strongest and most successful mortgage-type, student-loan agencies in

the world. Under the leadership of a visionary president and with support from two successive World Bank loans since the mid-2000s, ICETEX has extended coverage to 19 percent of the students, focusing on students from the lowest socioeconomic groups. This is the highest student-loan coverage rate in Latin America. ICETEX has also improved its collection record—reducing overdue loans from 22 percent in 2007 to 13 percent in 2009, and modernized its management practices, bringing operating costs from 12 percent in 2002 to 3 percent today. It has also entered into partnerships with participating universities to provide not only financial but also academic and psychological support to loan beneficiaries, which has greatly reduced dropout rates among loan beneficiaries, compared to students without a loan.

However, this situation has faced two types of troubles in recent years. First, with the economic crisis, a growing number of graduates found it difficult to meet their repayment obligations. The proportion of graduates who are not current with their loan payments has reached 17 percent. Second, the Chilean crisis has spilled over to Colombia. Students from both public and private universities have demanded the abolition of fees across the board, increased funding for public tertiary education and the transformation of student loans into grants. One afternoon, a few months ago, they went to protest in front of ICETEX and ended up smashing a few of the building's windows. Robust pressure from the streets, through mostly peaceful demonstrations bringing students and teachers together, forced the government to withdraw the draft Higher Education Reform Law from congress.

CONCLUDING LESSONS

Many years ago, my Student Loan mentor—Professor Bruce Chapman—shared with me in confidence the three secrets for running a successful student loan scheme: the first one is collection, the second is collection, and the third is collection. At the end of the day, no matter what type of student-loan system operates in one's country, it is doomed unless you have a proper collection mechanism.

Traditional, mortgage-type student-loan schemes are vulnerable by design, as illustrated by the Chilean and Colombian cases. Without an income-contingent provision, times of economic crisis are bound to create difficulties, as unemployment rises and incomes stagnate.

Obviously, income-contingent loan systems have a higher probability of success. But the necessity of having a foolproof collection system makes it challenging for most developing countries. My sense is that Chile is better placed than Colombia to work through its income tax administration to collect student-loan repayments in an efficient way. This is one of the positive consequences of the recent crisis, which has forced the Chileans to come up with a more rational and effective approach to student-loan origination and collection. I would hope that Colombia does not need a crisis of such gravity to find ways of transitioning to an income-contingent, student-loan model that would allow ICETEX to further consolidate its recent progress. In fact, ICETEX has already opened the possibility for graduates to move to an income-contingent repayment schedule. Two-hundred graduates took advantage of this new option in 2012. If this

approach proves to be successful in making repayments easier, ICETEX can hopefully extend it to all loan beneficiaries.