

Student Loans in Comparative and International Perspective

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In higher education systems across the world, the trend toward increased cost sharing in public universities and the growth of private institutions have led to the creation of many ways to assist students in paying ever more of their own education and related expenses. These modes of assistance fall into two categories: grants and loans—though it could be argued that service agreements, in which a student's education expenses are paid in return for work or public or military service, constitute a third major category of aid. Both grant and loan programs draw support from a variety of sources—public, private, nonprofit, and nongovernmental. Grants are essentially gifts, whether to help the brightest, the poorest, the most interesting, the most enterprising, the most well-connected, or simply the luckiest students. Student loans, however, are not as easy to characterize. Depending on the terms, a loan may resemble a grant or may actually increase the cost of higher education over time. Inflation and other unpredictable economic vagaries can also contribute to that outcome. The institutions that capitalize and administer student loans can do so out of benevolence or out of a desire to turn a profit. While student loans can be an effective equity tool to help students who otherwise could not afford higher education, their cost and difficulty of procurement may negate any equity effect. Student loans seem to defy straightforward analysis.

Student loans as an instrument of financial aid are all the more curious when we consider the findings of research on student loans and the practice of lending. The literature tells us that—especially in developing coun-

tries or in times of high inflation—student loans are not always an efficient or even a practical way to assist students in gaining access to and paying for their education.

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Administration of student loans is often said to be complicated and expensive, while student tracking and repayment can often be difficult or impossible to ensure. Indeed, the literature cites program cost and student default to be the top reasons for program failure. Nevertheless, student loan programs continue to proliferate with each program attempting to beat the odds. What is so appealing about student loan programs? Is it the notion of student self-help or the idea that lending institutions might be able to save or even make money from such an enterprise? Whatever the reasons, student loan programs continue to be a growing presence in higher education the world over. It is for this reason that we hope to capture some of our information about student loan programs. We hope that these short contributions will stimulate discussion and analysis so that we can refine our understanding of student loans—their role, advantages, drawbacks, and general character. ■

Student Loans: The World Bank Experience

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An International Perspective

Student loan schemes exist in more than 60 countries, making them an increasingly important financing mechanism for higher education. Traditionally, public agencies have run student loan programs, but in recent years new loan agents have appeared: commercial banks, for-profit

private agencies, and nonprofit institutions. Many schemes are national in scope, but in the State of Sonora a very effective public agency has operated since 1981. In Brazil, in the State of Rio Grande do Sul, a group of alumni created a successful student loan foundation in the 1970s (FUNDAPLUB). Student loan institutions (SLIs) worldwide are funded by the following sources: governments, students, firms, alumni, and international agencies. In addition to the repayments by beneficiaries and income generated through their own financial investments, public agencies often receive additional funding through budgetary contributions, either from the national government or

from a provincial government. Other possible sources are proceeds from a national lottery (Brazil), a payroll tax (Panama), a tax on profits of commercial banks (Costa Rica), and a gambling tax (Hong Kong).

In a 1992 World Bank review (*Deferred Cost Recovery for Higher Education*) of international experience with student loan schemes in industrialized and developing countries, authors Albrecht and Ziderman found mixed results. Because of heavily subsidized interest rates, high default rates, and high administrative costs (up to 25 percent in many Latin American schemes), the repayment rate of loans has not been significant. In many cases, it would have been cheaper to substitute loans with outright grants. Even those loan programs that have functioned reasonably well in developing countries—such as ICETEX in Colombia, CONAPE in Costa Rica, or FUNDAPEC in the Dominican Republic—are relatively small in scale.

A number of countries are adopting income-contingent loan systems, in which loan repayments are a fixed proportion of a graduate's annual income. The administration of income-contingent loan systems is generally simpler and cheaper than with other systems, because loan repayment and recovery is handled through existing collection mechanisms (e.g., tax administration, the social security system). Income-contingent loans are also more equitable, since graduates' payments are in direct proportion to their income. The student support system in Sweden, for example, minimizes the risk of student default by limiting repayments to 4 percent of income after graduation. Ghana collects payments through the national social security system. In Australia, income-linked loan payments are made through the tax system. Even though income-contingent loans offer considerable promise, their feasibility depends heavily on the existence of a reliable income tax or social security system.

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World Bank Experience

The World Bank's first association with student loans came in 1992, with a project to assist the conversion of the Venezuelan Scholarship Foundation, FUNDAYACUCHO, into a SLI. The Bank is presently supporting the establishment or strengthening of SLIs in Jamaica, Brazil, Mexico, Hungary, Bulgaria, and China.

SLIs can face bottlenecks along any one of the following dimensions: demand, funding and coverage, financial viability, and targeting. Demand problems occur when students are unaware that loans are available or when the financial products offered are not attractive. Students need to know of the existence of the program and understand the obligations involved (grace period, repayment obligations, interest rate, etc.). The attractiveness of student loans is determined by cultural factors such as attitudes toward borrowing and risk aversion, by the economic terms of the loans, and by the credibility of the student loan agency.

Funding problems reflect constraints on the availability of financial resources to offer new loans and to expand coverage. To compensate for declining public resources, the more enterprising SLIs tap funds from private sources. ICETEX in Colombia and FUNDAPEC in the Dominican Republic administer trust funds for student loans on behalf of companies and philanthropists.

If loan programs are to be financially viable in the long term, interest rates must be raised to compensate for inflation and keep returns positive in real terms. FUNDAPEC is one of the few private student loan agencies operating successfully with a positive interest rate. As part of a reform supported by the World Bank, the Sonora Institute has also raised its interest rate to eliminate the 20 percent subsidy introduced in the aftermath of the Mexican peso crisis of December 1994.

Loan programs require effective collection mechanisms. The Sonora Student Loan Institute has managed to keep defaults at acceptable levels (12 percent), thanks to an efficient management information system and a philosophy of personalized relations with the beneficiaries. By contrast, FUNDAYACUCHO in Venezuela was regarded for a long period as a lenient institution that did not care about loan collection.

The collection of delinquent loans can be enforced through moral persuasion, legal suits, credit blacklisting, the publication of a "shame" list, or the seizure of collateral assets. The feasibility and effectiveness of each approach depends on each country's cultural norms and legal practices. In Colombia, one of the better private universities (Universidad de los Andes) works closely with the ICETEX to encourage its graduates to keep current with their loan repayment obligations. The design of the SOFES student loan agency in Mexico presents innovative features to minimize the financial impact of default. Each of the 32 private universities who own SOFES is directly responsible for on-time repayment of the loans contracted by its individual students.

Targeting is an issue if there is leakage, when the social characteristics of the selected beneficiaries do not correspond to the planned distribution of recipients. The Student Loan Bureau of Jamaica has had a higher than expected

proportion of beneficiaries from the wealthiest quintiles. Rigorous selection and screening criteria are needed to address targeting issues. In countries without reliable income tax data, SLIs have no choice but to use indirect parameters such as data on family assets and educational background, in order to screen applicants properly.

Overly stringent guarantee conditions can also eliminate applicants from the poorest families. In Poland, where in 1998 the government established a student loan scheme managed through commercial banks, many eligible students were turned down because they were unable to satisfy the guarantee conditions imposed by the banks. To address this issue, SLIs can establish a guarantee fund to help those students from the lower income groups that find it difficult to secure adequate collateral. Such a guarantee fund was built into the design of SOFES, the new student loan agency in Mexico set up by the Federation of Private Universities.

Beyond their primary social role of providing financial aid, loan programs can also have a positive impact on the quality of higher education through the eligibility criteria imposed on both beneficiaries and participating institutions.

Finally, it is worth underlining that SLIs are extremely sensitive to sudden shifts in economic conditions. The Mexican peso crisis in December 1994 forced the Sonora Institute to lower its interest rate to protect students from high inflation, which worked to the detriment of the Institute's financial viability. The Argentinean student loan body, INCE, went into bankruptcy in the late 1980s, a direct casualty of the hyperinflation period. The 1998 downturn in the Colombian economy, combined with ill-advised financial investments, has forced ICETEX to reduce its coverage, from 12 percent down to 8 percent of the student population.

Conclusion

By their very nature, SLIs face a perpetual dilemma. As instruments of equity promotion, they serve an important social purpose in providing funding to students from low income groups. As financial institutions, they must operate in a sustainable manner. These two inherently antagonistic objectives are difficult to reconcile.

Beyond their primary social role of providing fi-

ancial aid, loan programs can also have a positive impact on the quality of higher education through the eligibility criteria imposed on both beneficiaries and participating institutions. Also, because they are more aware of the value of their education, student loan beneficiaries often achieve better academic results than their peers who have not received loans. ■

Financing Higher Education: The Potential Contribution of Fees and Student Loans

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Significant shifts have recently taken place in attitudes of governments, international agencies, and donors toward higher education. Optimism and growth in the 1960s and 1970s, when budget allocations for education tended to rise, driven both by rising social demand and by belief in the economic benefits of investment in human capital, gave way in the 1980s to stagnant or declining budgets, as governments in many parts of the world grappled with political and economic crises, structural adjustment, and widespread poverty and unemployment. At the same time, many donors switched priorities and emphasis away from higher to primary education, partly as a result of arguments that primary education was a more profitable social investment than higher education.

Demands of the "Knowledge Economy"

In the 1990s the balance again shifted, as increased emphasis on the "knowledge economy" and on the social and economic benefits of higher education led to reassessment of its role and to pressure for expansion, more equitable access, and improvements in quality of higher education. The recent report, published by the World Bank, *Higher Education in Developing Countries: Peril and Promise*, by the Task Force on Higher Education and Society, argued that "Higher education simultaneously improves individual lives and enriches the wider society, indicating a substantial overlap between private and public interests." At a time of severe financial constraints, however, the crucial question is how these "overlapping interests" should shape the financing of higher education, in particular what should be the