Making Student Loans Work in Africa

D. Bruce Johnstone

Abstract

Cost-Sharing—meaning the shift of a portion of the costs of higher education (including the costs of student living) that may once have been borne predominantly or even exclusively by governments, or taxpayers, to parents and students—has been deeply contested, but found to be financially necessary (and according to many analysts more equitable) in more and more countries, including in Sub-Saharan Africa. Student loans have been part of this process, allowing students the opportunity to invest in their own further educations, placing needed revenue in the hands of students supposedly at less cost to taxpayers than outright grants (presuming loan recovery), and providing colleges and universities (again presuming loan recovery) with revenue that would not be forthcoming from governments. However, African student loan programs have been largely unsuccessful at providing significant net revenue supplementation: that is, after covering the cost of capital as well as the costs of originating, servicing, and collecting plus covering the substantial costs of defaults. This essay analyzes some of these problems and suggests some principles for making student loans work better in Africa.

Le partage des coûts – c'est-à-dire le transfert aux parents et étudiants d'une partie du coût de l'enseignement supérieur (y compris le coût de la vie), qui était auparavant pris en charge majoritairement ou même exclusivement par le gouvernement, ou plutôt les contribuables– a été fortement contesté mais est devenu nécessaire (et selon de nombreux analystes est plus équitable) dans un nombre croissant de pays, notamment en Afrique sub-saharienne. Les prêts étudiants font partie intégrante de ce processus, donnant aux étudiants l'opportunité d'investir dans leur propre éducation, en mettant les revenus nécessaires entre les mains des étudiants, en principe à moindre coût pour le contribuable que les bourses (en présumant le remboursement du prêt), et fournissant aux établissements d'enseignement supérieur

(toujours en présumant le remboursement du prêt) des revenus qui ne proviennent pas des gouvernements. Cependant, les programmes de prêts étudiants en Afrique ont largement échoué à fournir d'importants revenus complémentaires, une fois couverts le coût du capital ainsi que les frais de dossier, de service, de collection, et le coût considérable des défauts de paiement. Cet essai analyse certains de ces problèmes et propose quelques principes pour que les prêts étudiants fonctionnent mieux en Afrique.

Introduction: The Diverse Aims of Student Loan Programs

There are probably more than 90 student loan programs throughout the world, with differing aims as well as differing amounts that can be borrowed as well as differing repayment obligations and degrees of subsidization. Although there has not been a recent census as of 2015, we studied 13 African student loan programs in 2009, and there are undoubtedly more today.[1]

The success of any of these student loans must be measured in terms of their specific program objectives, but also in terms of their political acceptability and financial sustainability—without which, whatever short-term success the programs may enjoy, they will not survive. And the higher educational landscape of Africa is littered with the remains of failed student loan schemes. This article draws on many years of examining higher education finance, tuition fee policies, and student assistance and loan schemes throughout the world to suggest a few principles: both for why so many student loan programs throughout the world fail, and then how to make student loans work better in Sub-Saharan Africa and other low-income countries and regions of the world.[2]

Principal Purposes of Loan Schemes

The principal purposes of student loan schemes can be viewed as one or more of the following six:

1. To put money in the hands of all students: Student loan schemes that are generally-available to all students without regard to financial need or to their own credit-worthiness or the credit-worthiness of their parents, can be very costly to the government. The cost to the government, which in virtually all cases of generally-available student lending is the lender, or at least the guarantor against the risk of default, depends on the numbers and average amounts of the loans, the degree of subsidization built into each, and the cost of absorbing defaults. Because these costs are inevitably very high, the provision of loans to all or most students generally requires capping loans at small amounts, leaving additional fees and the much higher costs of student living to come from parents or other sources, and doing relatively little to ease the financial burdens of higher education, particularly of needy students.

A further limitation on such loan programs in Africa is the fact that large-scale, generally-available, student loan schemes are generally unable to tap banks or other institutions of the private capital market without a governmental guarantee. International lending agencies such as the World Bank require even a guarantee of such loan schemes to be expensed on the government's operating budget, forcing loan guarantees, just like loans themselves, to compete with all other claimants on the operating budget. This places a major constraint on the scale of any comprehensive student loan program in African countries, with their typically limited taxing and borrowing capabilities and their formidable queues of socially and politically compelling competitors—like elementary and secondary education, health care, and desperately needed public infrastructure—for these limited governmental revenues.

2. To put money in the hands of financially needy students in a way that expands participation: Such a purpose requires a student loan scheme that is *means-tested*, or need-based, limiting available loans to students who have a remaining financial need after considering all other sources of revenue. As the recipients in many African countries would be from low income families—and frequently from rural or otherwise marginalized families—who may not have been exposed to a modern credit culture and who may be unwilling or unable to even co-sign a loan, such schemes should anticipate high rates of default and high costs to the government or taxpayer (although considerably less than the cost of loans given to all students).

3. To implement a degree of cost-sharing: A student loan program facilitates a shift of some of the costs of instruction and/or student maintenance from either the government or the family to the student. These student-borne contributions may provide increased institutional revenue, allow greater access, promote more equitable participation, and expand higher educational options, including in some schemes to a more costly private sector. The ability to borrow may permit a higher overall standard of student living and/or more independence from students' families (although the real beneficiaries in such cases would be the parents more than either the students or the universities). Of

[1] Marcucci, Pamela and D. Bruce Johnstone. (August 2010). *Cost-Sharing in Sub-Saharan Africa*. Buffalo, New York: University at Buffalo Department of Educational Leadership and Policy, presented by the authors in 2010 to the World Bank under contract #003300465.

[2] This essay draws heavily on Johnstone, D. Bruce and Pamela Marcucci. (2010). *Financing Higher Education Worldwide: Who Pays?* Who Should Pay? Baltimore: The Johns Hopkins University Press.

course, a student loan scheme that is linked to revenue supplementation as well as accessibility requires that loan recovery be a priority: that is, that the two principal sources of losses—from excessive subsidization and from excessive defaults—be kept to a minimum. The purposes of the enhanced revenue made possible by the cost-sharing, in turn, may be expansion of capacity, enhancement of quality, provision of more targeted (i.e. means-tested) financial assistance, a substitution for tax-based governmental revenues, or any or all of the foregoing.

4. To influence institutional or program selection: Eligibility for student loans can be made contingent upon the recipient selecting certain institutions (e.g. rural, or newer, or non-university institutions) or certain programs or fields experiencing manpower shortages (e.g. teacher education, nursing, or engineering).

5. To encourage academic progress and/or success by forgiving portions of principal for years of academic success: This aim, central to the student loan program in South Africa, is as much a monetary reward to incentivize good student behavior than a loan *per se*. Such a program is expensive and depends on an assumption that desirable academic behavior—for example, achieving high grades or, less ambitiously, simply finishing on time—responds *cost-effectively* to the prospect of a future reward in the form of a repayment forgiveness, as opposed to other methods of eliciting the desired behavior. (Such a provision could be thought to be cost-*in*effective if many or even most of the student borrowers who are academically motivated and able enough to avail themselves of this reward would finish their academic program with distinction anyway, with or without any loan forgiveness.)

6. To influence post-graduation practice or venue: Finally, a student loan can be given for the aim of influencing the choice of the student as a graduate to practice a certain profession and/or to practice in a certain target venue: for example, the practice of medicine, nursing, or teaching in a rural district. This can be accomplished by granting or even requiring most students in the chosen academic programs (e.g. medicine or nursing or elementary education) to complete with a relatively high level of indebtedness, portions of which can then be forgiven for each of several years of practice in the target venue. Such loans (sometimes referred to as workforce contingent loans) assume that professionals will be motivated to do what they would likely not otherwise do—for example, teach or practice medicine in a remote village for little salary—because of the prospect of debt forgiveness. Also, a possible public policy assumption may be that student debt forgiveness is more cost-effective (or more politically feasible) than alternatives such as higher salaries, first year bonuses, subsidized housing and transportation, and other incentives that might target public resources to the same end.

The idea of coupling substantial tuition fees with student loans and some kind of *workforce contingent* repayment forgiveness may be especially compelling in Sub-Saharan Africa, where an expensive higher education in medicine or dental medicine or even in nursing or teaching, may have been covered entirely by regressive taxes or inflationary deficit financing borne by average taxpayers and citizens, with the recipients likely to practice in the major cities—or unfortunately and even more inequitably, by emigrating to Europe or North America, which then benefits from the advanced professional education paid for by the African taxpayer. In such cases, the imposition of a high tuition fee that would be forgiven simply by remaining in the country for a period of years, and perhaps by spending a couple of years in a rural village, would serve the health needs of the country and provide a more equitable means of financing the costly advanced professional education.

Student Loans in Africa

Student loan programs in Africa were created initially not to support cost recovery, but as a means of supporting student living expenses supposedly in a less costly manner than grants (or stipends or bursaries). However, early loan programs such as the Nigeria Student Loans Board scheme in Nigeria and the University Students Loan Scheme in Kenya made little effort to collect outstanding loans—which were in any event excessively subsidized and differed only marginally from grants. As Sub-Saharan economies faltered in the last decades of the 20th century and as enrollment demand—and thus the costs and revenue needs of African colleges and universities—surged far beyond the ability of governments to cover, cost-sharing policies began to appear, such as tuition fees, enrollment caps on public institutions, fee-paying tracks within the public universities (particularly in East Africa), the imposition of fees for formerly free food and lodging, and the encouragement of demand-absorbing, fee-dependent private colleges and universities. In response to this cost-sharing imperative, student loan programs were begun, expanded, or re-tooled to bring real cost recovery and to allow students and their families to share in the costs of higher education by covering at least some of the costs of instruction as well as the costs of student maintenance. Thus, as in the rest of the world, student loan programs were created in Africa along with cost-sharing policies to meet the twin and somewhat competing goals of increasing university revenue from non-government sources, as well as expanding access to traditionally under-served populations. In fact, given the prevailing low incomes in Africa, effective implementation of almost any degree of cost-sharing, or revenue supplementation, almost requires some form of student lending to succeed. For example, the original 1974 Kenyan student loan was substantially revised in 1995, and the Kenyan Higher Education Loans Board (HELB) was created with an explicit aim of supporting new cost-sharing initiatives as well as to support the expansion of access. HELB was given legal authority to collect all outstanding loans given under the Higher Education Loans Fund (HELF) set up by the British colonial government in 1952 (tabled upon independence) and the University Students Loan Scheme set up in 1974. Similarly, new student loan agencies were established in Tanzania and Rwanda to give new loans to needy students and to collect on loans that had been given under the older loan schemes that had had no interest rates stipulated, no collection machinery—and unsurprisingly virtually no recovery.[3]

Problems of Student Loan Programs in Africa

The recovery of student loans in Africa, as in most low- and middle-income (and even some high income) countries, continues to be problematic. Depending on the program, the problems giving rise to excessive costs and insufficient recoveries can be any or all of the following features:

Excessive subsidization: Many student loan programs feature interest rates that are far below market rates and even well below government borrowing rates. Most charge no interest during the in-school years and also during a grace period. Some subsidization (beyond covering losses from defaults) is probably essential and realistic for generally-available student loans, given the high costs of student loan administration and given the fierce opposition to all forms of cost-sharing, including payment of high rates of interest. But too many loan schemes are subsidized to the extent that they would not begin to recover the costs of capital and servicing even with otherwise acceptable rates of default. And many of these excessively subsidized interest rates are a function of political pressures from student unions and opposition parties that cater to the students' resistance to any form of cost-sharing, including student loans.

Very high rates of default: The pervasive non-repayment of loans in Africa, as in most low- and middle-income countries, may be for quite different causes, including so-called willful default, as well as the simple inability to repay due to high unemployment or other causes. In addition, much of the high rate of non-repayment is at least partly the fault of poor origination, inadequate skip-tracing, inadequate legal means to enforce collection efforts, and other manifestations of poor program administration. In many of the loan programs in Africa, already overworked government bureaucracies are expected to run new student loan schemes in addition to their other work, and to do so with inadequate staffing, insufficient or out-of-date paper record systems, little or no staff training, and too few links to other governmental agencies, such as those responsible for banking, tax collection, and fraud investigation.

Inadequate targeting or means-testing: Means testing is imprecise – again, especially in most low-and middle-income countries, where wage and salary incomes as well as interest and dividend income and all manner of off-the-books income is at best imprecisely known to authorities. The result of this inadequate and sometimes fraudulent targeting is the granting of costly subsidized loans to students whose families could have afforded the modest fees or maintenance expenses without the loans, and whose enrollments do not require the loans—which thus impose the need for ever more stringent limits on the size of loans that are essential for the truly needy students.

Excessively short repayment periods: Very short repayment periods—perhaps set to theoretically maximize the flow of repayments and lessen the need for new governmental revenue can lead to unnecessarily high monthly payments and actually worsen the repayment flows by contributing to high defaults. At the same time, *excessively long repayment periods*, especially where loans carry high subsidies, can lead to greater than necessary governmental costs.

Inefficient program administration: Frequently the revenues provided for program administration, including originating, servicing, and collecting student loans, as mentioned above, are inadequate for the formidable task of launching and operating a successful student loan program. But whether the resources are sufficient or not, a related and common problem may be inefficiency due to any number of factors, including political patronage in leadership roles, insufficient training of key staff, lack of coordination with the colleges, universities and other key governmental agencies, inadequate computerization of records, and other failures.

Excessive loan forgiveness: There is a place for debt forgiveness in a workable student loan program: inability to earn a living, for example, or incentivizing certain kinds of post-graduation, socially-beneficial behaviors. But like other public subsidies, debt forgiveness may be given too easily, or too generously, or for mere political expediency, and thus detract from the larger aim of revenue supplementation for the benefit of higher education.

[3] Marcucci and Johnstone, pp. 14-18.

In the end, a student loan program can achieve a number of policy aims. But the costs of a student loan program, even when supposedly integrated into a larger scheme of revenue supplementation, can be extremely high. Given the extensive and continuing public costs of a comprehensive, generally-available student loan scheme, and given the scarcity of public revenues in all Sub-Saharan African countries and the long queue of competing needs, student loan programs must be mindful of unnecessary costs. At the same time, even the best student loan schemes that are responsive to political realities and to the need to avoid excessive debt loads will be costly. In the final analysis, defaults on generally-available student loans (that is, available without regard to the creditworthiness of the borrower), particularly in African countries where unemployment is often high even among university graduates, and where true credit cultures may be just beginning, will be high. The government will almost always have to absorb at least some, if not all, of the risk. The requirement of a co-signatory or co-signatories—generally parents or other members of an extended family—is the principal way of lessening the financial exposure of the government. But many families simply do not have the assets that might be seized in the event of default – not to mention the serious public relations and political costs involved in seizing the assets of otherwise reputable citizens whose child has defaulted on a student loan.

At the other extreme, a recurring—and seriously mistaken—theme in new student loan scheme proposals worldwide, with no basis either in theory or actual practice, is that a student loan program that avoids the aforementioned problems can eventually become self-sustaining: that is, with capital for new lending and the expenses of program administration coming entirely from the repayments on previous loans, thus producing a program of student assistance that will require no further governmental subsidy. It is entirely possible for a student loan program targeted to credit-worthy advanced professional students such as masters or doctoral students in medicine, computer science, law, or business to be self-sustaining, if administered professionally; indeed, such students can get bank loans in most countries. However, it is extremely unlikely that repayments on past loans in any comprehensive, generally-available student loan scheme will ever be sufficient to become the sole source of new lending. This is due to the inevitably extensive losses from defaults and built-in subsidies (both of which can be lessened with higher rates of interest and better collection procedures), and also to the increasing volume of new lending needed to keep up with the combination of increased dollar needs per student and the almost inevitably increasing numbers of new student borrowers.

More important, however, there is no reason even to aspire to a *revolving,* or *self-sustaining* student loan program. The amounts coming in via repayments have almost nothing to do with the amounts that should be – or can be – lent out to new or repeat student borrowers. At its most efficient (and independent of new government capital), a student loan program should aspire to having the present discounted value of the anticipated stream of future payments from each cohort of new lending come as close as possible to the dollar value *of those loans*—less only the government's share of defaults (which will be considerable) and any subsidies built into the loan program to achieve special policy goals such as enhancing the higher educational participation of rural or ethnic minority students.

What is discouraging about this recitation of problems is that they are so pervasive throughout the world—and perhaps especially in Africa, where workable loan programs are so needed. But what is encouraging, or at least giving room for hope, is that these problems are generally known and are in the main correctable.

Summary: Making Student Loans Work in Africa

Following are some summary points pertaining to the potential role of student loans in Africa, and how to make them work more effectively. These points are implied by the principles of cost-sharing, the experiences (both positive and negative) of student loans schemes throughout the world, and by the mixed record of student lending in Sub-Saharan Africa.

1. The case for comprehensive, governmentally-sponsored student loan programs in Sub-Saharan Africa begins with the inescapable fact that higher education's costs and revenue needs in virtually all countries of the region are rising faster than the available governmental revenues that have historically been the major support both of the institutions and of student living costs. Although the economies of many African countries are improving in the second half of the century's second decade, difficulties of taxation and the competition from other public needs has led to a paramount need in African higher education to supplement governmental revenues with other revenues—principally through forms of cost-sharing, or turning to parents and students to bear more of the surging costs of higher education.
2. Student loans have the potential to supplement (even if only slightly) the very scarce governmental revenue in the countries of Sub Saharan Africa. Student loans, when working effectively, do this by allowing a portion of the costs of instruction and/or

expenses of student living to be shifted to students, to be repaid when they enter the workforce, thus providing additional revenue to support the enhancement of capacity, quality, and accessibility of higher education, as well as to improve student living standards—and in some countries to further the independence of young students from their parents.

3. As or even more important than the revenue supplementation provided by the loan payments themselves, the overriding purpose of a governmentally-sponsored and publically-subsidized student loan program is to allow a measure of revenue supplementation through tuition fees and other forms of cost-sharing, while providing necessary financial assistance to the many students who cannot afford the fees and the other costs of attendance. A workable governmentally-sponsored and publically-assisted student loan program can provide this essential student assistance in a way that can be less expensive—and thus can allow more financial assistance to more needy students—than a program of non-repayable grants, or bursaries.
4. A *workable* student loan scheme is one that: (a) reaches a substantial number of students with enough (but only just enough) borrowed money to make a difference in their ability to access an appropriate level and kind of higher education—but with care to avoid aggregate debt levels that cannot be repaid; (b) prioritizes the (always limited) public revenues available to support student lending to accomplish the (also necessarily limited) policy goals of the student loan program (these goals may include such policy aims as, for example, favoring the most needy or the most academically able, or favoring students from certain regions or ethnicities, or assisting kinds of institutions or an emerging private sector); (c) is fiscally sustainable—that is, features a sufficient rate of interest to minimize (but not necessarily to eliminate) the need for continuing governmental interest subsidization; (d) is as recoverable as possible, given the reasonably anticipated non-repayment rate[s] of the target borrowing population[s]; and (d) is able (at least in its mature phase) to tap a domestic and/or international private capital market and not (or no longer) have to rely only on the government's annual operating budget for all of the funds required for new lending, for the costs of origination, servicing, and collecting, and for absorbing the always high costs of default.
5. In order for student loan schemes to provide the necessary large volumes of student financial assistance required in African countries more cost-effectively than low or free tuition for all, and also more cost-effectively than non-repayable grants for the needy, two conditions must prevail. First, the student loans must carry a real, or at least a *minimally subsidized*, rate of interest (i.e. in the vicinity of the government's own borrowing rate). Second, the loans must be at least *substantially collectable*: that is, defaults and other forms of non-payment must be held to reasonable levels. Lessening defaults can be accomplished through a combination of: (a) good lending practices (including assuring that student borrowers are fully aware of their eventual repayment obligations and of the consequences of default at the time the loans are taken); (b) providing ways to defer repayments and avoid default in the event of unemployment or temporary loss of income; (c) effective skip tracing of borrowers in repayment; and (d) the ability to collect, when necessary, from guarantors and co-signatories. In short, defaults on generally-available student loans, even with co-signatory requirements, are unavoidable—but can be lessened.
6. In financial terms, the discounted present value of the reasonably anticipated repayment stream—after allowing for some inevitable defaults and other sources of non-recovery, and including the cost of money and the costs of administration—should be at least significant (say, 25 to 50 percent of the amounts lent, depending mainly on the reasonably anticipated level of defaults).
7. A myth that has contributed to poor loan design is that student loans in Africa must be heavily subsidized in order to make repayments manageable. The *manageability* of repayments can be enhanced, of course, through greatly subsidized rates of interest—but only at considerable cost to the lender (effectively, the government). But more important—and far less costly—ways to enhance manageability are policies to control: (a) the aggregate amount that is allowed to be borrowed and owed at the initiation of repayments; (b) the length of the repayment period, which establishes the level of monthly payments; and (c) the "shape" or nature of the repayment obligation (that is, whether the loan is to be repaid in equal installments, or in installments that are graduated over time, or that are to be repaid on a fully *income contingent* basis. Student loans must be kept to a manageable aggregate total, repayable over a sufficient period to make the actual monthly payments manageable as well, and desirably amortized over time in such a way as to recognize that the ability to repay may be minimal in the first years after graduation. In addition, every student loan scheme—even if calling for a conventional fixed-schedule (that is, non-income contingent) repayment obligation—should have a provision to defer

some of the amount owed in the event of chronic unemployment, illness, or other justifiable reason.

8. Another, and quite contrary, myth that is sometimes promulgated by over-zealous proponents of student loans is that once funded or initially capitalized, a comprehensive, or generally-available, student loan program can eventually become "self-sufficient," with incoming repayments equal or at least nearly equal to required new student lending, and thus no longer dependent on new injections of governmental or private capital. This is a recurring theme of new student loan proposals both in Africa and the highly industrialized world, with no basis either in theory or in actual practice. Thus, while a comprehensive-but-*workable* student loan program can provide necessary student assistance at a lower cost to the government and taxpayer than grants or free tuition, the program will require a constant—and probably an increasing—level of new governmental appropriations.

If a student loan program conforms to the principles enumerated above and can demonstrate a high probability of real recovery, the student loans become no longer simple *expenditures*—like grants, and thus totally dependent on annual appropriations—but *assets*. Private business or consumer loans bearing market rates of interest and sufficient security can, as assets, be sold or securitized to provide the capital for new lending. Student loans, at least in theory, should also have value that could be sold to pension funds or other institutional investors, or could be securitized (that is, be used as collateral for additional debt) in order to secure revenue for new lending. The value of a student loan (or a bundle of student loan notes) depends on the rate of interest borne by the notes and the likelihood of full repayment (or the converse: the likelihood of default). Thus, the ability of student loan schemes to sell or securitize their notes and tap the larger private capital markets depends entirely on the strength and certainty of the anticipated repayment stream—and thus on the interest rates and the strength of repayment guarantees. African student loan schemes, typically bearing below market interest rates, at substantial risk of default, and oftentimes without full governmental guarantees, would have difficulty tapping the private capital market in this way. Nevertheless, all student loans should be viewed as assets of some value; the aspiration to someday be able to sell or securitize them and tap the larger private capital markets is a good measure of a truly workable student loan program.

Conclusion

As a final summary point: Student loan schemes in Africa, as in other middle- and low-income countries struggling with steeply rising costs and revenue needs in their systems of higher education, can play a useful supporting role within a comprehensive program of higher and post-secondary education financing. In this supporting role, student loans should complement a comprehensive program including public investment in new higher educational capacity, sector diversification, middle and secondary school reform, the cautious expansion of tuition and other forms of cost-sharing, a cost-effective system of targeting financial assistance on the most needy, the encouragement of a quality private sector with a system of accreditation and student consumer protection, and steps toward granting greater autonomy—with accountability—to public institutions and systems. This is a daunting list of needs; and new initiatives in higher educational finance must compete for attention and scarce public revenue alongside of all of the other equally complex daunting challenges facing the governments and non-governmental agencies of Sub-Saharan Africa. And if this challenge were not enough, aspects of cost-sharing including tuition fees, financial assistance, and student loans, probably receive more political contention than is warranted. It is within this context that student loans can play their supporting role—and with care can be made more workable.