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STUDENT LOANS

Economic and Political Considerations Underlying Student Contributions to the Costs of Higher Education

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Abstract
This paper outlines the combinations and interactions of *financial* and *political* aspects that may be necessary in order to successfully implement a policy of cost-sharing in higher education that includes students – and thus, that must include student loans. All too often, governments begin consideration of student loans without thinking through – deliberately and transparently – the economic and political considerations that underlie the very concepts of cost-sharing and of governmentally sponsored student loans. This paper discusses 12 decisions that must be considered, in both their financial and their political contexts before implementing a student-loan programme – for instance, the division of this "appropriate share" between parents and students, or between students and entities in case of loan default. These questions and considerations are critical for policies related to public sector tuition fees, means-tested financial assistance, student loans, and regulations covering government grants to private college and university sector.

Introduction: Cost-Sharing and Student Loans[1]

Throughout the world, with some European countries being the principal exception, most governments however reluctantly and however much they may obfuscate their policy, have acknowledged the need for higher educational cost-sharing. Cost-sharing is both a statement of fact – that the costs of higher education are shared, principally among governments (taxpayers), parents, and students – and also a reference to a particular policy wherein some of the costs of higher education are shifted from being borne mainly (or even entirely in the cases of formerly Socialist/Communist countries) by the government (i.e., the taxpayers or the general citizenry) to being borne as well (or increasingly) by parents and students (Johnstone, 1986, 2004; Johnstone & Marcucci, 2010a). Such a policy may be *reluctantly accepted* as an unfortunate but necessary policy driven by the inadequacy of available public revenues, or it may be *positively adopted* as a logical policy consequence of an underlying acceptance of the benefits of markets and a belief that cost-sharing can yield greater efficiency, better quality, and more equity in the provision of public higher education. But in any case, it will be contested: by those who believe that all of education should be paid for by taxpayers as a matter of ideological principle; by some who might accept some cost-sharing even though they do acknowledge that it will hinder access for the poor (in spite of grants and loans); and by others who have gotten used to the taxpayer-supported benefits and will not easily give them up.

Once a policy of cost-sharing has been accepted – however reluctantly – the implementation of cost-sharing requires policies and programmes of:

[1] An earlier version of this paper was prepared for the International Symposium on Student Loan Policy, organised by UNESCO Bangkok and the Students Loans Fund of Thailand, Bangkok in 2006; updated in 2011 for UNESCO Latin America Institute of Higher Education (IESALC) and published in Spanish in *Educación Superior y Sociedadis* (*Journal of Higher Education and Society*); and further revised, updated, and edited in January 2015.

- tuition fees: fees to cover a portion of the underlying costs of instruction;
- other fees: principally for food and lodging that may have been (along with the costs of instruction) subsidised wholly, mainly, or partly by the government;
- grants, bursaries, or discounts: shifts the cost back to the government or taxpayer, and that are designed mainly to influence student behaviour and mainly to make possible higher educational participation on the part of young people from low-income families who would presumably not otherwise have been able to partake of higher education; and
- loans: deferred contributions from students in order to assume a portion of the costs burden but necessarily to defer payment until they have finished their higher education and are in the workforce.

This paper is about loans, and about the economic and political considerations that must be taken into consideration in their design. All too often, governments begin consideration of student loans without thinking through – deliberately and transparently – the economic and political considerations that underlie the very concepts of cost-sharing and of governmentally sponsored student loans. The very essence of cost-sharing is a policy requiring students and/or families to pay for something (even if only a small share) that they may have come to believe was an entitlement (and have likely been encouraged to believe so by politicians and parties especially on the political left). There is a constant and powerful pressure to shield parents and students from these costs, even if the consequence is not a return to higher educational revenues borne by taxpayers, but simply the loss of revenue to the colleges and universities and the increasing austerity and overcrowding that such policies imply (Johnstone & Marcucci, 2010a).

In similar fashion, economists and policy analysts sometimes begin their recommendations regarding cost-sharing and student loans from only a financial vantage, either ignoring or even rejecting the existence of political considerations as well as the sometime daunting technical problems that may be required to implement their recommended policies. This paper is an attempt to outline the combinations and interactions of the *financial* and the *political* that may be necessary in order to successfully implement a policy of cost-sharing that includes students – and thus that must include student loans.

Rationales for Cost-sharing and Student Borrowing and Lending

Although there are several quite different (and even somewhat contradictory) rationales in support of a student-loan system, the following four are the most commonly cited. First, a system of student loans is the only way that students can participate significantly in the sharing of higher educational costs. As noted above, the appropriateness of students bearing a portion of the costs of higher education has now been accepted by the governments of most countries and most economists and policy analysts throughout the world, mainly because students themselves are a major beneficiary (along with government or the general citizenry) of the benefits of this higher education.[2] However, because students generally have little money at the time they are students, but generally have significantly enhanced earning power afterwards as a direct result of this education, the student contribution must normally be deferred and repaid when the student is employed. In fact, as the government, or taxpayer, will continue to pay most of the costs of this valuable higher education (most often supplemented by contributions from parents or other members of the family), the student's deferred contribution, further subsidised by virtue of what is usually a favourable rate of interest, can be looked at as an exceptionally good private investment in their careers, and indeed in their lives.

Second, in addition to investing directly in their university education through deferred tuition fees, students can also, through student loans, pay for a portion of the cost of their own food and lodging and can generally, if they wish, attain a better standard of student living than might otherwise be available to them in recognition of their greater present need for, or value upon, money. This kind of investment is what economists refer to as the expression of a *time preference* for current money or current purchasing power. Students generally have very little purchasing power *now*, but have considerable purchasing power in their *future* (i.e., through their higher incomes when they later enter the workforce). Thus, they are said to have a *high present value for money*, and are logical *borrowers* – as compared to *savers*, who have more purchasing power than they need now and so are willing to sell (i.e., *lend*) their current purchasing power for a price that we term "interest".

A third rationale for students bearing a portion of the costs of their higher education – and thus for student loans – is that making a monetary investment in their higher education in what is generally the only way (i.e., through a student loan that must someday be repaid), the young adult generally becomes a more serious and a better student as well as a more discerning consumer of the higher education that he or she is now helping to buy. (Admittedly, this is more of a rationale for governments to pursue policies of cost-sharing – which happen to require ways for students to defer their costs – than a preference of students for a way to borrow.)

Finally, there is a possible mutual advantage – that is, to both the government and the student – in having students contribute to their higher educations in part through loans. Governments subsidise higher education in part because there are specific social needs that require trained professionals practising in certain venues: for example, teachers, doctors, nurses, agronomists, and engineers practising in rural parts of the country. As such specialties and such venues are frequently less desirable, trained professionals may not want to devote their entire working lives to such practice, but might well be induced to practice in, say, in a remote village for their first four or five years after their training if there was a sufficient financial

[2] It is important to view these *benefits*, or *returns*, as far more than the easily observed enhancements to the students' earning power (and presumed productivity) as measured by higher salaries. Just as, or more, significant can be enhanced career options, opportunities for more desirable and rewarding jobs (above and beyond any greater salaries), opportunities for advancement, greater job security, and the status or social prestige that accompanies a university degree.

inducement. An efficient way for the government to encourage such short-term practice is for the government to pay, in effect, a salary premium by forgiving a portion of student loans due for each year that the young teacher or agronomist or physician practices in a specific target location.[3]

Essential Decisions/Questions in Policies of Cost-sharing and Student Lending

Political as well as financial considerations are present everywhere in the consideration of higher educational cost-sharing and are also present in the design of the policies and programmes. The remainder of this paper considers the interplay of these economic and political considerations in the design of a student-loan programme. Specifically, we shall consider 12 decisions that must be considered – in both their financial and their political contexts – before implementing a student-loan programme.[4] They are presented in an approximate order in which they are best considered.

The first six "considerations" deal with the underlying concept of cost-sharing and the degree to which student loans are to be part of higher educational policy.

1) The very appropriateness of cost-sharing (meaning a shift of underlying instructional costs to parents and/or students)
2) The division of this "appropriate share" between parents and students
3) The amount of any tuition fee (whether paid upfront by parents or deferred and paid by students)
4) How (if at all) tuition fees should vary
5) How tuition fees should increase over time
6) The division of the expense that is to be borne by (most) students that should be borne by loans as opposed to earnings

The final six "considerations" deal specifically with student loans.

7) The form of the repayment obligation: that is, whether it is to be a fixed schedule of repayments (a conventional mortgage-type loan), a percentage of future earnings (an income contingent loan), or a "hybrid" obligation (a fixed repayment schedule unless the borrower in repayment can demonstrate an excessive burden)

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[3] An alternative kind of financial inducement, of course, would be to raise the salary. However, this would almost certainly require a raising of all salaries – including those already practising, for whom the salary increase would be in the nature of a windfall (albeit arguably well-deserved). Repayment forgiveness, on the other hand, is efficient because it targets the subsidy only on the recently educated who have the most alternatives.

[4] As is frequently the case in matters of policy, these questions can be ignored – *but to ignore is also to decide* – and frequently to decide in ignorance of the consequences, alternatives, and trade-offs.

8) The degree of subsidisation built into the expected repayments for most borrowers (for whatever form of the obligation)
9) The entity or entities that are to bear the risk of default, or non-repayment (regardless of the form of the obligation and whatever the amount of subsidisation)
10) The form and the "generosity" that is accorded to the student in repayment who finds the repayment burden burdensome or impossible to meet (whatever the form and whatever the subsidisation)
11) Other policies and purposes (i.e., other than repayment relief as alluded to in question #10, above) by which repayments might be forgiven
12) The degree (if any) to which whatever degree of governmental subsidisation and assumption of default risk to be attached to the basic student-loan scheme might also be employed in support of a private, largely tuition-dependent higher educational sector

Let us turn to this list of fundamental questions and discuss each in the light of the combination of economic as well as political considerations that must be weighed as a country contemplates either the start of a new student-loan scheme or whether their current scheme needs altering (radical or otherwise).

1. The very appropriateness of cost-sharing: Cost-sharing is the official belief – together with the requisite implementing policies – that most parents and/or most students should bear some portion (usually in the range of 10 to 40 per cent) of the underlying costs of publicly provided higher educational instruction. This share is appropriately called a *tuition fee* whether it is required *upfront* (and generally paid by parents, as in the United States, Japan, the Netherlands, or China) or *deferred* (and generally paid by the student, as in Australia and England).[5] A tuition fee can also be inferred to be *appropriate* even under circumstances in which a government claims adherence to a policy of *free* higher education – as long as a substantial (and financially critical) number of students are regularly admitted to most programmes on a fee-paying basis (as in the so-called *dual tuition* programmes found in Russia and many other former Communist countries as well as most of East Africa).

Economists and policy analysts tend to support cost-sharing in higher education because they view it as both more efficient and more equitable. The latter assertion is based on the observation that public higher education in virtually all countries is partaken of disproportionately by the sons and daughters of the more affluent, but is financially supported, at least in most countries, largely by consumption or value-added taxes or deficit spending, measures that fall equally disproportionately on the middle and lower classes.

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[5] Somewhat amusingly, at least to an outside observer, first Scotland and then England and finally Wales all succumbed to the political pressure to roll back tuition fees, not by (as those doing the political pressuring wanted) eliminating the hated tuition fee and shifting back to all taxpayer-borne costs, but by simply shifting from *upfront* tuition fees, which parents pay, to deferred fees, which students pay (see Johnstone, 2005; Richards, 2002).

However, such an argument, valid though it may be, is contested by assertions that the tax system could be made more progressive or more bountiful if there were only the political will or administrative skill to do so: assertions that attempt to portray cost-sharing as mere political decisions to *not tax* or to *not tax equitably*, or to *tax ineptly*. Or, the implementation of cost-sharing can be portrayed as merely a bad or even corrupt decision of public resource allocation: that is, wasting money on wars or temples or allowing money to be stolen though corruption rather than spending the available revenues on worthwhile things like public higher education.

A simpler but more politically sensitive justification for cost-sharing is to allow the proposition that there is waste and corruption in the expenditures of many governments, and that there are flaws in most tax systems. However, the combination of (1) the steeply rising costs of higher education, driven by rising per-student costs and accelerated by rising participation and enrolments, and (2) the very long queue of socially and politically compelling needs in the public sector – from public health to elementary and secondary education to public infrastructure and many other needs – means that higher education is simply not in a position to claim enough of the increased public revenues *even if they were to be forthcoming*. In short, the *reluctant acceptance* of cost-sharing may be a more politically acceptable – as well as a substantively very sustainable – rationale for cost-sharing.

2. The division of "appropriate **share" between parents and students:** The next question that must be addressed after an acceptance (or rejection) of the notion of cost-sharing itself is the appropriate division of the share between parents and students. The rationales are quite different: the case for a *student share* is based on the likely private returns to the higher education, and the case for a *parental share* is based in part on the notion of the student as a financially dependent child and in part on an assumption of considerable private benefits extending to parents as well as to students. If we pose it as a question: Is the student to be considered an independent adult (as in the Nordic countries) and thus to bear all or most of the cost burden that the government/taxpayer either cannot or will not? Or, is at least part of the burden to be assumed by the parent – making the student to be considered a financially dependent child for this purpose? European students, partly because they are frequently a year or two older than their American or Japanese counterparts and partly also because the students unions that purport to speak for students tend to be allied with the far political left, tend to resist the notion of the *expected parental contribution* and the policy treatment as a *financially dependent child* – at least as long as the alternative is to be supported by governments (taxpayers). In contrast, American, Canadian, Japanese, Chinese, African, Southern European, and most of the Latin American countries that have accepted some degree of cost-sharing, as well as most of the *dual tuition* countries accept the notion that the parents have the obligation – in so far as they are financially able – to support their children's higher education, at least through the first degree and at least until some age.

The relationship of this issue to student loans is that the student-as-a-financially-independent-young-adult absolutely requires some way for the student to defer his or her share of higher educational expenses – that is, a student-loan programme – unless all expenses for all students are to be borne by governments, which no governments in the 21st century seem willing or able to do (other than perhaps Cuba and North Korea). The problem with the deferral of *all* tuition fees is that such a policy seems to turn down most of what parents in most countries have shown themselves willing and able to contribute. The Scandinavian countries may be wealthy enough and have a sufficiently strong and efficient tax system (as well as a higher education system with minimal enrolment growth) to generate all the revenue needed by the public colleges and universities. Most countries, however, either lack this tax capacity or (as is the case in the United States) prefer to have lower taxes and to shift more expenses to parents, who seem willing and able to pay at least something for their children's higher education.

At the same time, in countries that have a powerful legacy of very big government and a tradition of entitlements to education and to other public goods and services, the opposition to tuition fees may be truly formidable and at least temporarily insurmountable. In such cases, expressing the tuition fee in terms of a *deferred student obligation* rather than as an *upfront fee to be paid by parents* may be politically wise and perhaps the only way for the tuition fee to be enacted. Australia is probably the best example of a very successful tuition fee implemented in part under the cover of a *deferred student obligation* – which had the further political advantage of not even having to be called a "student loan" (Chapman, 2002). In Ethiopia, the decision to implement a cost-sharing policy with a deferred student obligation rather than an upfront tuition fee was strictly a political choice, designed to surmount the anticipated political opposition to tuition fees in a country that was both desperately poor and that still carried much of the legacy of extensive entitlements from African Socialism. In Ethiopia, the efficiency of the loan recovery was less of an issue than the prospect for getting some revenue from the students when there was none before. (This is a rationale that does not work in a country like the UK, which has essentially *walked away from* what was a financially successful, as well as equitable [by virtue of its being means-tested], tuition fee paid by parents in favour of additional debts upon students.)

3. The tuition fee: If there is to be cost-sharing in the form of a tuition fee – whether the tuition fee is to be collected up or deferred – what is an appropriate level of a tuition fee? This question is best answered as a *percentage of underlying undergraduate institutional operating costs that are to be covered by the tuition fee.* (This might also be thought of as the search for the appropriate ratio of tuition fees to the per-student taxpayer subsidy.) While tuition fees vary widely around the world, a range in terms of the percentage of underlying costs of instruction might be:

- low or nominal (less than 5 per cent),
- medium–low (5 to 15 per cent),
- medium (15 to 30 per cent),
- medium–high (30 to 40 per cent),
- high (more than 40 per cent).

The *appropriate* level, then, depends on many factors such as the effectiveness of means-tested grants, the sufficiency of a generally available student-loan programme, the existence of a tuition-dependent private sector, the possibility of attending a college or university while living with parents, and so forth. Whatever the level, the advantages of the *percentage of underlying instructional costs* method of establishing an appropriate tuition fee are the following (Johnstone & Marcucci, 2010a; Marcucci & Johnstone, 2007):

- It is conceptually defendable in that it recognises the appropriateness of constant shares (albeit increasing underlying costs).
- It recognises the appropriateness of greater tuition fees for the more costly forms of instruction (although provision must be made for certain high-cost programmes that have very high contents of public benefits, such as the sciences).
- It treats students equivalently or evenly (albeit charging more for the more costly programmes).
- It lessens the need to return to the political process for the necessary tuition fee increases over time.
- It reinforces the obligation of the government to also maintain its share as the underlying per-student costs increase.

As we are assuming that all or most of the student-borne expense, including deferred tuition fees and any student-borne costs of living, will have to be borne by student indebtedness? This question may also take the form: What is an appropriate level of student indebtedness? Posed this way, the answer must consider the degree of subsidisation built into the loan (which we will take up in #8, below), the repayment period (which make debts more manageable, although does not really lessen the burden), the prevailing salaries among graduates of the programmes under consideration, and any provisions for deferment or ultimate forgiveness if the salaries are unable to carry the repayment burden.

4. How should tuition fees vary: Once a tuition fee has been found to be appropriate, it is necessary to consider how (or whether) that tuition fee should vary. Should it vary not at all, that is, require the same tuition fee for all students? Or, should it vary according to the underlying instructional cost of the programme, the level of the degree (i.e., undergraduate, graduate, or advanced professional), the sector of the institution (research university or first-degree college), the expected earnings of graduates (i.e., the probable ability of the borrower to amortise a debt), or the market demand for the degree? In a politically volatile climate, where the very notion of a tuition fee might well still be only reluctantly accepted, a critical question is whether to charge a substantially higher fee for programmes in high demand (such as medicine, engineering, management, or computer and information sciences), in which higher fees might be justified by any or all of the following: (a) the generally (but not always) higher underlying costs of such programmes; (b) the generally (but not always) greater private benefits in the form of higher salaries and greater status to the graduates of such programmes; (c) the generally greater ability to repay a student-loan debt for graduates of such programmes; (d) the likelihood that the students choosing and/or getting accepted into such programmes are likely (but not always) to be from more affluent families; and/or (e) the greater market demand for certain faculties and programmes (which more or less sums up all of the aforementioned rationales).

5. How should tuition fees increase over time: It makes no sense to have a tuition fee that never increases while all other prices increase and the tuition fee becomes worth less and less in real (i.e., inflation adjusted) terms. So, should fees increase with the rate of inflation? Should they match the increases in underlying per-student operating costs (which tend generally to be even greater than inflation)? Should they fill in gaps left by declining tax revenues? Or, as is common but is to be avoided if possible, should the necessary rate of increase (or lack thereof) be left to the annual political process? As discussed above, a preferred scheme is one that allows or even expects fees to increase automatically, but only as the underlying per student costs increase. The disadvantage to the government is that it implicitly obligates the government also to increase its per-student contribution in addition to the funding of enrolment expansion.

6. The amount of expense that is to be borne by (most) students by loans as opposed to earnings: This is an option not even available in many countries, where part-time jobs are scarce or where the option of working and earning may be discouraged by a requirement that all students be full time or by the sheer academic workload required. However, in the United States and increasingly in Europe, the option of working (generally part time) and earning is a real option and can be seen either as: (1) an alternative to borrowing, (2) an alternative to parental financial dependence, or (3) a way to have more income and presumably to enjoy a higher standard of living.

Clearly, excessive part-time employment can detract from study time and can thus contribute either to lower academic achievement or to a disinclination to enrol in academically rigorous subjects, both of which are socially problematic. Excessive part-time employment when taken to minimise borrowing can also be an economically irrational choice: that is, lengthening time to degree completion and possibly jeopardising achievement, all in order to minimise borrowing, when that borrowing might have allowed more time to be devoted to study and to timely completion, leading to earlier entry into a well-paying job – and the relatively easy amortisation of the student debt.

7. The form of the repayment obligation: To the degree to which students are to contribute to the costs of their higher education and thus need access to student loans, the first question in the design (or redesign) of a student-loan programme may be the form of the repayment obligation: most specifically, whether the obligation is to be a *fixed schedule of repayments* (a conventional mortgage-type loan), a *percentage of future earnings* (an income contingent loan) or a “hybrid” obligation (e.g., a fixed repayment schedule unless the borrower in repayment can demonstrate an *excessive burden* – for example, that the required payment exceeds some maximum percentage of earnings).

Income contingent loans, in which the repayment obligation is expressed as a percentage of the borrower’s earnings, are increasingly capturing the fascination of policymakers and politicians. As provided in Australia, New Zealand, England, and several other countries, 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 and political advantages. However, some of these advantages are not in themselves properties of income contingency, *per se*, but of features that can as easily be built into conventional fixed schedule loan forms. For analysts contemplating new governmental student-loan programmes, it is well to keep in mind four qualifications, or caveats, to the all-too-common presumption of the superiority of the income contingent loan form.[6]

First, an income contingent loan is still a loan, and in spite of some presentations to the contrary it is not *per se* any less expensive or even easier – for most student borrowers – than a conventional loan merely because the repayment obligation is expressed as a percentage of income or earnings. For most student borrowers, the *expensiveness* or *inexpensiveness* 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 reasonably anticipated repayment stream. The income contingent loan can be made inexpensive for all or most borrowers only with a governmental subsidy – just like the conventional fixed-schedule loan. On the other hand, manageability is measured by the ease of the repayments at a point in time. Manageability can thus always be enhanced by reducing the individual repayments (for a conventional loan) or by lowering the percentage 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 (e.g., the discounted present value of the eventual repayment stream).

Second, 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 – like 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 upfront, 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 parents are given the choice of accepting the income contingent loan, which goes directly to the university and is repaid by the student, or paying upfront, which is likely to be paid by the parents but at a considerable discount.

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[6] The following points are covered in greater depth in Johnstone (2009) and Johnstone and Marcucci (2010a, pp. 175–179).

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 *upfront*) 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 force employers to collect student-loan repayments – just as it requires employers to withhold income taxes and to collect pension or insurance contributions. But 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 be applied as well to the collection of conventional loans. This observation in of itself does not deny the attractiveness of either income contingency or employer collection of the debt. But 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: for example local taxes, child support, alimony, or the cost of automobile insurance – conceivably weakening the primary purpose of tax collection, which is to make possible necessary public expenditures. Furthermore, an obvious corollary to the presumed advantage of employer-mandated debt collection tied to income tax withholding is that a government that has difficulty collecting taxes and pension contributions from its citizens – which difficulty surely describes many low- and middle-income and transitional countries – can hardly be expected to be able effectively to collect payments on an income contingent loan or graduate tax obligation.

Finally, an income contingent loan presents some complications and potential losses 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 borrowing and a non-borrowing member of the family all constitute problems for the financial viability of an income contingent loan scheme. Highly industrialised 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 other countries, including most of the developing and many of the transitional countries, where sources of income or earnings are frequently multiple, highly variable, and often unreported, the problem of establishing the repayment obligation may be considerable and seems to invite misrepresentation and almost certain repayment shortfalls.

In sum, there is no denying the political attractiveness of implementing a tuition fee in such a way that does not sound like a tuition fee and that is to be collected in a way that can be made to seem almost painless. At the same time, by downplaying (or not mentioning at all) the politically treacherous concept of tuition fees, a government may be able to get an element of cost-sharing that it would likely be politically unable to get were it to advocate openly even the relatively modest tuition fees that such plans generally entail. And to the degree that the political resistance from students is a function of a genuine fear of unemployment or underemployment and the possibility, then, of unmanageable debt, loss of credit, and other misfortunes, the income contingent loan may indeed be superior. However, when the overriding need of the government is for maximising upfront tuitions and for capitalisable repayment streams, when many graduates (borrowers) are likely to hold multiple short-term jobs or to be employed in the informal economic sector or are likely to be emigrating, where there is little tradition of voluntary, self-reporting of income, and where state systems for monitoring and verifying incomes are non-existent or unreliable, income contingency may not be the most appropriate form of repayment obligation for the purpose of cost-sharing or revenue diversification.

8. The degree of subsidisation built into the loans: Whatever the form of the obligation, the most fundamental issue in student lending is its purpose. If the purpose is to put money into the hands of students to maximise accessibility (and political acceptability) – and to generally ignore the purpose of cost-sharing, which is to generate non-governmental revenue – there will be a temptation to subsidise the loans heavily. If, however, the purpose of the lending, at least in part, is to shift some of the costs of higher education to the student in the only way possible – that is, a student loan – then the need is to minimise subsidisation and maximise the present value of the repayments. Since both purposes are present in virtually all student-loan programmes, the answer has to be some kind of compromise, mainly between political acceptability and financial necessity.

Political pressure will be for high subsidisation and lower effective student interest rates. On the other hand, very high governmental subsidies obviate the supposed need for cost-sharing in the first place – which is to shift some of the cost burden from the taxpayer to the student. By another perspective, excessive subsidisation carries extensive *opportunity costs*: that is, forgone alternative governmental expenditures, which might, for example, be more loans at lesser amounts of subsidy, or more grants, or additional operating revenue either to improve university quality or to expand capacity (and thus participation). In addition, high subsidies require *rationing*, which in turn must be based primarily on family financial need in order to prevent subsidised loans from simply displacing parental contributions and further subsidising the upper middle class. But rationing by *means-testing* adds both administrative costs and opportunities for unfairness and corruption. A reasonable compromise is probably *minimal subsidisation*: an interest rate high enough to assure some recovery and to discourage unnecessary borrowing (and thus to minimise the need for extensive family-income verification – which would probably be futile anyway in many countries), but still subsidised enough to be politically palatable and to control excessive student indebtedness.

9. The risk of default: Whatever the form of the obligation and whatever the amount of subsidisation built into the programme, there will be defaults and some entity or entities must bear this risk. All *generally available* (i.e., not restricted to the lowest-risk borrowers) student loans carry a high risk of default. This high risk is a function of four factors: (a) the absence of collateral; (b) a typically high degree of early borrower mobility, when the recently completed students is often traveling in search of jobs or for other purposes and is consequently difficult to trace; (c) immaturity and unfamiliarity with credit generally; and (d) the length of time between the disbursement of the loan and the initiation of repayments. Such a risk generally calls either for a governmental guarantee, thus enabling a student-loan programme to tap the private capital markets of banks, pension funds and other major sources of savings, or for government itself to be the lender, effectively originating the student loans either from current tax revenue (like any other governmental expenditure) or from revenue borrowed from the national and or international capital markets and added to all other governmental borrowing, to be repaid from future tax revenues.[7]

To the degree to which the student-loan scheme depends on governmental tax revenue, of course, the scheme has not achieved the immediate purpose of diversifying the sources of revenue for public higher education. However, governmental lending also yields student repayment obligations, which are *assets* and are not the same as *outright expenditures* (e.g., like student grants). At the same time, good accounting in the case of governmental student lending requires a considerable set-aside allowance for possible defaults. In the same way, governmental guarantees (which are necessary to promote private lending), encumber the government with *contingent liabilities*, which for accounting purposes, ought to be about the same as the allowances for bad debts in the first instance of governmental direct lending – illustrating the fundamental financial similarity of *lending* and *guaranteeing* (Johnstone & Marcucci, 2010b).

The International Monetary Fund and other major international lenders, however, generally do not recognise the offsetting value of student-loan obligations as assets and may require the loans to be treated as simple expenditures for purpose of calculating allowable governmental deficits. This means that there may be a need to get the student loans and any guarantees off of the government's books by *securitisation*, or selling the loans (and their risk) to the private sector – obviously at a considerable discount. Default risk can also be lessened through judicious use of co-signatory requirements, with the government as a primary guarantor only for families with insufficient collateral and then a secondary guarantor for families who are able to co-sign the loan and bear a part of the risk. But in the end, student loans are inherently risky and governments will usually be required to at least share in the risk of a student-loan programme that is widely available to all or most students in need.

10. Repayment forgiveness for students unable to repay: Many student borrowers will have difficulty making full repayments on their student debts,

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[7] It is true that repayments add another stream for new borrowing. However, the trajectory of annually increasing loan capital needs and the constant losses from subsidisation, defaults, and debt forgiveness mean that repayments will nearly always constitute an inadequate source of new lending and must therefore be supplemented by additional new capital, either from the capital market or from the government's current operating budget.

especially in the early repayment years when the student borrower is still searching for stable employment. By the terms of the repayment obligation, income contingent lending carries an automatic provision for lessening the repayment obligation or even for ending it altogether after the student borrower has paid for many years, but whose income remains too low to amortise the debt at the initial interest rate. The *hybrid* fixed-schedule-income–contingent-loan also carries such a provision allowing the low-earning student, whose payments are insufficient to amortise the debt, to be eventually released from any further repayment obligation. Both cases effectively provide a governmental subsidy not on the basis of the low income of the family when the borrower was a student, but on the basis of the student's own lifetime low earnings. In either event. there will be a *degree of generosity* necessarily built into the terms of the obligation that can provide relatively easy or relatively onerous, exit from further repayment obligations for the low earner. For example, a generous forgiveness feature might initially require a relatively low percentage of earnings to be devoted to debt amortisation and a relatively short maximum repayment period. An ***un***generous or onerous feature might require a relatively high percentage of earnings to be repaid, and might also hold the low-earning borrower in for many years in order to attempt to recover the full loan at the initial interest rate. In short, while there is both substantive and political purpose in providing eventual repayment forgiveness for those whose incomes turn out to be low and whose investment in their higher educations might be thought to not have "paid off" – at least not in higher earnings – the generosity (or lack thereof) of this provision – and, of course, its cost to the taxpayer – depends entirely on terms and conditions that are built into the loan scheme in the first place.

11. Other provisions for repayment forgiveness: There are other possible purposes – that is, other than repayment relief – for which repayments might be *forgiven*. Such purposeful repayment forgiveness is sometimes attached to student loans in order to influence post-graduation borrower behaviour: for example, a decision to practice a certain profession (e.g., teaching or nursing) and/or in a particular venue (e.g., a remote village).[8] These tend to be popular with politicians because they seem to be for a good cause – and most importantly, they do not seem to cost anything (at least not in the year that the provisions were enacted into law and the politicians presumably reaped the political benefit). But of course there is a cost, which can be expressed in likely present value terms and which carries opportunity costs like any other repayment subsidy.

12. The use of governmentally sponsored and governmentally subsidised student loans to subsidise a private higher educational sector: Private higher education is flourishing all over the world (least so in Europe). Private higher education provides efficiency, responsiveness, and relief from the need to subsidise publicly all higher educational enrolments. In Latin America and some of Asia, where public higher education has been kept relatively small and elite, much of the private sector is referred to as *demand absorbing*, and is avowedly less prestigious

[8] See Kirshstein, Berger, Benatar and Rhodes (2004) for a compilation and analysis of what the authors call "workforce contingent" student loans.

(although at times preferred for its efficiency and market responsiveness). In this way, private higher education serves public as well as private purposes and thus presents a legitimate claim on public resources.

At the same time, public support to private higher education is politically opposed by those who see it as just one more instance of *privatisation*: undertaken not so much for purposes of promoting efficiency or market responsiveness, but to cover an alleged or perceived *defunding* of an important public enterprise (i.e., public higher education) for the purposes of better serving business, lowering taxes, or stifling the voices of faculty. In such a climate – where the principal case for a publicly supported expansion of private higher education may be much the same as the case for cost-sharing more generally (i.e., the unlikelihood of the public higher education getting substantially more of the available or foreseeable public revenues) – an extension of governmentally sponsored student lending to students electing private institutions may be the most efficient and least politically controversial form of public support. Coupled with effective accreditation, tax benefits to private giving, and the maintenance of quality public universities – all of which are likely to preserve the preeminent status of the public institutions – a robust private sector can indeed serve the public interest and easily justify the relatively modest public subsidy implied by opening up a minimally subsidised student-loan programme to students in the private sector.

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These questions and considerations are critical for any country to consider both as it may be inclined to introduce a programme of cost-sharing or as it may need to refine and adjust its cost-sharing policies – most especially, its policies of public sector tuition fees, means-tested financial assistance, student loans, and provisions for financially aiding a private college and university sector. The twelve considerations listed above may help this process.

Note

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