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International

From the issue dated December 7, 2001

Student Loans: a Slippery Lifeline

As more countries institute tuition, borrowing has become crucial and fraught with problems

By BURTON BOLLAG

With tuition costs going up worldwide, a growing number of countries are throwing young people a new financial lifeline:

ALSO SEE: student loans. But those lifelines are proving to be slippery.

Bigger Burden for Students

In India, Government Loans Do Little for the Poor or for Private-College Students

In Russia, a Loan Program Vanishes, Leaving Students Scrambling

In China, Student Loans May Be Expanding Societal Gaps They Were Supposed to Close

A rapid increase in enrollments in recent years has put huge strains on the budgets of countries that traditionally have had free or low-cost public higher education. More and more countries are requiring students and their families to share education costs by paying tuition. Loans are supposed to prevent higher education from becoming an

exclusive privilege for the children of the affluent.

But student-loan programs, difficult to get right even in the United States, where they have been around since 1958, are proving even more prone to failure elsewhere. Three of the world's most populous countries -- China, Russia, and India -- have tried to start loan programs in the past two years, but the only one that could be called operational, in China, is plagued by problems. In some countries, programs have been run so inefficiently that administrative costs have eaten up as much as a quarter of the money available for loans. Elsewhere, little of the money lent out was recovered, because few graduates bothered to repay their loans, or governments charged students such low interest rates that the loans ended up functioning largely as grants. Loan programs exist today in some 60 countries, but in many nations they reach only a small share of the young people who need them.

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## **Finding the Right Balance**

"The trick is to find a balance between providing subsidies to needy students, and making loan programs financially sustainable," says Jamil Salmi, deputy director for educational policy at the World Bank, which is currently helping about a dozen countries establish or strengthen loan systems.

Loans may be intended to reduce the pain of rising fees, but that doesn't mean students are always happy about them.

"Loans put people in a trap," says Jacob Henricson, chairman of the National Unions of Students in Europe, known as ESIB. "If you don't have a very large salary, you're going to have problems repaying."

In Europe, with the exception of Britain, public higher-education systems are still free or very cheap, and many governments provide students with stipends for living expenses and study materials. But as enrollments continue to climb, the stipends are beginning to come as loans, instead of grants. Mr. Henricson, a political-science student at the University of Stockholm, says that with Scandinavia's high living costs and expensive imported textbooks, it is not uncommon for Swedish students to graduate \$25,000 in debt.

Pressure from students and their families to make borrowing for college cheap leads to one of the thorniest problems policy makers face -- how much to subsidize interest rates on loans. A high subsidy, with students charged low or zero interest, means that, due to inflation, students end up paying back only part of the value of the money they borrow.

Nicholas Barr, a professor of economics at the London School of Economics and Political Science, says that when subsidies exist they unfairly benefit the middle class. Students usually come from the middle or upper middle classes and can afford to pay back loans at close to commercial rates, he argues. Without subsidies, loan programs are cheaper for the taxpayers, and more money can be made available to more students. Special assistance can then be provided to students from poor backgrounds, or graduates who go into low-paying but socially beneficial professions. But the middle class has considerably more political clout than the poor, Mr. Barr says, and policy makers often give in to their demands for cheaper loans for all.

That has been the case in Britain for the last decade. Interest on student loans has been kept so low -- generally equal to the inflation rate -- that the government has gotten back only about half of the value of the money it has lent out. Now there are

strong demands to reduce the interest-rate subsidy and give more help to those in greatest need.

### **Sharing the Burden**

One method for spreading out students' debt burden that has attracted international attention is Australia's national loan system, the Higher Education Contribution Scheme. Repayment is pegged to a graduate's income; repayment starts when he or she is earning at least \$12,000 per year, and is set at 3 percent to 6 percent of his or her income above that. So low earners pay back smaller amounts, but for a longer time. Another feature of the program is that administrative costs are kept down by piggybacking on the income-tax system. Payments are billed as a surcharge to income taxes and are generally deducted by employers.

Yale University tried another approach to promoting social equity in the 1970s. Some view the program as having been an embarrassing flop, others as a noble but flawed experiment. The World Bank's Mr. Salmi says it "illustrates how the implementation of a theoretically sensible and generous concept turned into a nightmarish adventure."

Under Yale's Tuition Postponement Option, graduates had to repay yearly 0.4 percent of their salary for each \$1,000 they had borrowed. (Tuition was considerably lower then.) Each borrower had to continue paying until the debt of their entire graduating class was repaid. The program unraveled when high-earning graduates realized they would have to repay far more than they had borrowed, subsidizing not only students in low-paying professions, but the 15 percent of graduates who were deadbeats. Few students realized how many classmates would renege on the loans.

Even where controversial social-policy issues have been resolved, collection of debts has often been a problem, especially in developing countries with poorly functioning or nonexistent tax and credit systems.

In the 1980s, Brazil, Venezuela, and Kenya each had loan programs with roughly 90-percent default rates. In an even worse case, an official body in Ghana recently reported that out of \$27.5-million loaned to more than 400,000 college students since 1988, only \$1.1-million has been paid back. "In many cases," says Mr. Salmi, "it would have been cheaper to substitute loans with outright grants or scholarships." But, he adds, "many countries have learned from their mistakes."

### **Lessons Learned**

Jamaica's government-sponsored loan system was near collapse three years ago because only about a third of loans were repaid. The biggest deadbeats were not low-income students, but those who became physicians and lawyers. As part of efforts to make the system more financially viable, the Student Loan Bureau began an advertising campaign appealing to students' civic duty, and published "shame lists" with the names and photographs of those with outstanding debts. Within months, repayments improved substantially.

Even the United States and Canada were plagued by high rates of default in the 1980s. At the end of the decade, U.S. officials began to refuse loans for study at institutions with graduates who had very high default rates -- generally for-profit colleges with poor programs that did not lead to good jobs. The default rate for most student loans -- government-guaranteed but provided by commercial lenders -- was 21.4 percent in 1989. Now, the rate is 5.6 percent. A strengthening economy contributed to the improvement.

A number of poor quality, for-profit institutions that lost the right to provide federal loans to their students were forced to close. The loan system thus played an important secondary role as an instrument for quality promotion. Some loan programs in developing countries, such as one in the state of Sonora in Mexico, have used a similar approach to try to steer students to stronger institutions.

The world's first national student-loan program, according to Mr. Salmi, was established because one graduate wanted to share his good fortune with others. In the late 1940s, Gabriel Betancourt, a young Colombian from a poor family, persuaded the manager of the company he worked for to lend him money to study abroad. He was so grateful for the opportunity that, after graduating, he successfully lobbied the Colombian government to establish a permanent loan mechanism. In 1950 he became founding director of the Colombian Student Loan Institution.

The institution continues providing loans today, but only to 6 percent of students -- down from a high of 12 percent -- due to a lack of government support.

In many poor countries with largely black-market economies and no formal income taxes, economists are skeptical about the possibilities of creating viable loan programs. "Without any means of tracing income, loan programs are not going to work, except on a small scale," warns Bruce Johnstone, a professor and director of the Center for Comparative and Global Studies

in Education at the State University of New York at Buffalo.

## Creating the Infrastructure

Although this means abandoning the pretense of making higher education available to rich and poor alike, Mr. Johnstone says very poor countries may have to settle initially for modest loan programs, perhaps providing the money only to those who can provide collateral, or to graduate students, since they would be more likely to obtain gainful employment after graduation.

With many poor countries, especially in Africa, only now contemplating the controversial decision of introducing tuition, the question of whether broadly available loans can work remains unanswered. But the World Bank, stung by past criticisms that its policies have hurt the poor, is committed to the idea. "No country should introduce cost sharing," says Mr. Salmi, referring to tuition payments, "without a proper mechanism for student loans and student aid."

### Bigger Burden for Students

As tuitions have risen at many colleges abroad, student loans have become less accessible. Here is the change in public-college tuition rates over the past six years for some countries, with the current average annual tuition:

	Percent increase, 1995-96 to 2001-2	Average annual tuition 2001-2
Britain	No tuition in 1995	\$1,523*
Austria	No tuition in 1995	618
Malaysia	97%**	429
South Africa	58%†	1,354
Canada	53%	2,398
U.S. (4-year)	48%	3,754
South Korea	18%	3,845
Japan	11%	3,978

Note: Rate of change was calculated using the local currency, without converting to U.S. dollars. Current tuition fees in U.S. dollars are based on the exchange rate on July 1, 2001.

\* Maximum; tuition is adjusted based on demonstrated need.

\*\* Estimated

† Increase since 1996

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