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

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New Delhi

When India's finance minister presented the government's annual budget last April, students heard the words they had long been waiting for. Everyone who wanted to go to college could now afford to, thanks to the government's new educational loan program, claimed the minister.

For Dinesh Kapur, who wanted to earn an M.B.A., the announcement was encouraging. He had applied to a private business college -- one of many recently opened to meet the huge demand for higher education in India -- and the tuition was far beyond his means. Even though Mr. Kapur's family is comfortably middle class by Indian standards, \$8,132 for two years of tuition is a rich man's prerogative.

Unlike his parents, who had never considered going to a bank for a loan, Mr. Kapur was not put off by the idea. During his visits to bank offices to check out the government's new loan program, he wasn't surprised by the high interest rates, which started at 12 percent, or the short repayment period of three years, nor that his parents had to show that they earned enough to pay back the loan if he couldn't. What surprised him was that he didn't qualify.

"Every bank has its own catch," says Mr. Kapur. One of the stipulations of the student-loan program is that the educational institute the student wants to attend must be government-approved. Even though it is regarded as among India's finest, the Infinity Business School, in New Delhi, Mr. Kapur's institution, still hadn't been certified. In addition, the bank wanted Mr. Kapur's undergraduate exam results, which were not available when he applied, nor was being ranked in the top 20 percent of his class good enough. "It's not just that the process is complicated and time-consuming," according to Mr. Kapur. "You have to read between the lines in every clause."

Feeling Duped

Looking back on the process, Mr. Kapur says he feels duped by the government's promise to make it easier for students to borrow money. He had paid close attention to the finance minister's budget address to the nation -- he had studied it for his undergraduate examinations -- and had believed that the government was committed to helping students meet the rising cost of education. In retrospect, he says, the government's words were disingenuous. The Finance Ministry simply handed down new rules for banks. The government didn't spend a rupee to underwrite the loans or to subsidize lower interest rates.

Those who are shortchanged the most, however, are the "poor but meritorious" students that the Educational Loan Scheme was designed to help. No poor students, as defined by the government, actually qualify for these loans. Parents of prospective borrowers must earn enough to pay back the loan themselves if their child defaults. Bank officials say they wouldn't touch anyone whose family earns less than \$209 per month.

That income requirement disqualifies most Indians, says Surya Narayana, a professor at the Indira Gandhi Institute of Development Research in Bombay. While the government says 26 percent of Indians, or 260 million people, are poor, Mr. Narayana says the proportion is closer to 75 percent. The government sets the poverty line at less than \$10 a month per capita, says Mr. Narayana, whose institute is affiliated with the Reserve Bank of India, the equivalent of the U.S. Federal Reserve. "That measures sheer deprivation. That is not poor -- it is abysmal poverty. I would say the number of poor in India, where their calorie intake is below minimum, is 75 percent. These people would never be able to afford a loan."

Public vs. Private

Yet an undergraduate education at state colleges and universities is actually affordable for even India's poorest -- if they can get in. Tuition for a year costs less than a movie ticket, and even total fees do not exceed \$45. The problem is that there are far fewer spaces than applicants at public colleges. The alternatives are privately run institutions of higher learning, which are far beyond the reach of the average Indian.

Mr. Kapur had, in fact, applied to a private business school. As the deadline to make a decision about his college finances approached, Mr. Kapur felt he had no choice but to go with a loan offered by a bank that had an affiliation with Infinity Business School. Although he will end up paying a lot more in interest than he would have under the government's program, Mr. Kapur still believes taking out a bank loan was the right thing to do. He is unfazed by the lending terms and the monthly repayments of \$312 per month that will begin as soon as he graduates. Although it is more than the \$250 a month his father earned as a mechanical engineer, for Mr. Kapur it is simply the cost of investing in his future.

"I'm very confident I will be able to pay it back," says Mr. Kapur, who feels he is practically guaranteed a high-paying job with a multinational corporation after graduation. "I don't have a second thought about it."

His mother, however, is from the old school. "I was shocked in the beginning," says Anita Rajiv Kapur, who tutored children at home to supplement her husband's income. The family always lived hand-to-mouth since most of their income went to send their children to one of Delhi's elite private high schools. Like many middle-class Indians, spending their money on education is still considered the best investment they can make.

Borrowing Without Banks

The Kapurs had taken out loans before, but never from a bank. Banks are usually the last place that Indians turn to for money. Most Indians prefer to ask family members for loans, which are secured with just a handshake. The other option is the system of private financiers, used by both the rich and the poor. "You have to be introduced," says a Delhi businessman who uses private lenders. "As long as someone vouches for you, and you are known in the community, you can get whatever money you want. If you need 10 lacks [1 million rupees] in the morning, it's delivered in sacks by the afternoon."

Of course, private financiers charge higher interest rates than banks, currently about 25 percent per year, not

to mention that the lending system is illegal. But what people like about the system is that nothing is signed and they don't have to provide collateral, which most people lack on paper. "My word is my collateral," says the businessman. "The government banks charge less, but the transaction pain is higher."

Until recently, people didn't think much of putting money in banks either. Those with money bought gold jewelry, which was often buried under the floor or sewn into the folds of the women's saris. Previous generations that lived through violent political upheavals, floods, and earthquakes were ready at a moment's notice to be on the move, taking their savings with them. The tradition continues as parents buy gold, not certificates of deposit, for their daughters' dowries, starting the day they are born.

Ms. Kapur, however, has changed as the culture of money has changed. She has a bit of gold, but she and her husband have also opened interest-bearing accounts as a way to see themselves through retirement, another novel notion in India, since male children have traditionally served as the parents' old-age pension. A few years ago the family even got a credit card, though she is still scared to use it. Taking out a loan for education, she says, now *that* was unheard of.

"God gives intelligence, but he should have given money also," laments Ramdas J. Kanath, the retired chairman of Canara Bank, one of India's largest. A few years ago, Mr. Kanath became concerned by the growing educational divide in India. The Indian Banks' Association appointed him to head a committee to examine the problem and recommend ways to reverse the trend.

The Government Plan

Under the plan he designed and the government adopted, the borrower's family does not have to put up any collateral for the first \$8,340. The interest rate is tied to a lending rate, set by the Reserve Bank of India. The rate is currently 12 percent. Larger amounts are charged progressively higher interest rates.

"No other loan is as good," declares Sudhir K. Mehrotra, the senior manager of a Punjab National Bank branch in New Delhi. The greatest benefit, Mr. Mehrotra says, is that the interest rate is simple, not compounded. "On a loan of 500,000 rupees at 15 percent, payable over three years, the interest would be 225,000. But compounded it would be 277,727. The savings to the student are huge." Over the life of the loan, a student would save more than \$1,000 in interest.

Although his bank has advertised the loans widely on campuses, Mr. Mehrotra still has had relatively few takers. This year he has made only five student loans.

While M.B.A. students such as Mr. Kapur, who see big salaries in their futures, may not lie awake at night worrying about the size of their loans, the thought gives others nightmares. Muneeza Naqvi had just been accepted to Columbia University's Graduate School of Journalism, in New York, when she heard about the government's loan plan. Even with a generous scholarship she knew she would never be able to afford tuition and housing costs that totaled nearly \$48,000 for one year unless she took out a huge loan.

"I was sort of lulled into believing that banks were suddenly saviors for students looking for funding," says Ms. Naqvi, who visited a number of local banks and researched loan terms posted on the banks' Web sites. "Far from it, I assure you."

"For me, the interest rates were the most worrying factor," she says. Because she would have needed to borrow a lot, her interest rate would also be high. Depending upon which bank and the amount loaned, the

rates fluctuated between 13 to 15 percent, which, she says, "was insane."

In the end, Ms. Naqvi did exactly what generations of Indians have done before her. She borrowed from friends and from family. There were no papers signed, not even a handshake. There was no talk of charging interest. There was just the promise to repay the loan and the implied agreement that she would do the same for someone else in the family when the time comes.

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