Alternative Objectives of National Student Loan Schemes: Implications for Design, Evaluation and Policy

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Introduction

Government-sponsored student loan schemes are in place in some fifty countries. Yet an examination of the working of individual country schemes displays considerable variation from scheme to scheme, defying any attempt to identify common or even 'best' practice. Some schemes are available to students across university sectors (both private and public); others are restricted to students enrolled in public sector institutions. Some schemes are targeted to particular groups while others are available to all. Many loan schemes, but not all, have been introduced in order to facilitate increases in tuition fees, aimed at greater cost recovery. Some loan schemes are highly subsidized, offering generous repayment conditions, while others operate at near to commercial conditions. In turn, the extent of loan recovery (and consequently the financial efficacy of the loan scheme) varies markedly across schemes.

These differences across national loan schemes stem largely from the differing objectives pursued. This article identifies eleven different objectives (in five category groupings) that have underscored loan schemes around the world. Following a discussion of these alternative objectives in the second, the third section examines the implications, for the operation of loan schemes, of adoption of particular objectives, and in the final section the article argues that student loan schemes should always be evaluated in the context of the central objective(s) that they are designed to achieve.

The article has been prepared in a precise format, in line with the constraints imposed by the timetable of this special issue. In due course a fuller, more detailed paper will be prepared, supported by country examples.

Alternative loan scheme objectives

The central objective and type of policies pursued differ from case to case. We may identify five different sets of objectives for student loan schemes, which in turn will influence the design and operation of the scheme as a whole, as well as its financial sustainability. These are: (i) budgetary objectives (income generation); (ii) facilitating the expansion of higher education; (iii) social objectives (improving equity and access for the poor); (iv) meeting specific manpower needs; and (v) easing student financial burdens. In practice, any given scheme may incorporate more than one objective.

Budgetary objectives (income generation)

Public universities throughout the world, and particularly in developing countries, are under-financed. Leaving aside situations where the university system is expanding (we deal with this subsequently), constrained government budgets may lead to a general under-funding of public universities. This may arise for a number of reasons; three are discussed here (see Table 1). First, additional government funding may not be available to enable universities to maintain enrolment levels and quality in the face of rising unit costs. Second, across-the-board cuts in overall government expenditures, including higher education, will pressure the public university sector to seek alternative funding. Third, many countries have adopted policies that favour basic, over tertiary, education, leading to a reallocation of funding away from the universities to other sectors of the education system that display higher social rates of return.

In all these cases, budgetary parsimony has resulted in public universities turning to greater cost recovery, in an effort to tap alternative sources of funding. The main thrust of these policies is to be seen in the introduction, or increase, of student payments for services received. These may take the form of higher, more realistic tuition fees or increased payments for subsidized lodgings and meals.[1] The raising of student fees, whether for tuition or living expenses, may be both politically and socially unacceptable; vested interests from all strata of society will actively oppose the imposition of private student expenditures, which may represent a multiple of current salary levels. Recourse to the banking system for loans to ease this payment burden may be unavailable; banks are notoriously loath to lend for education courses – a clear case of market failure. Hence there is a role for a government-backed student loan scheme, offered at commercial rates, to fill this gap. This would mean that students are able to finance their education and living expenses through resort to borrowing; the repayment burden is eased by the expected enhancement of earnings that the additional education makes possible.

Table 1
Alternative objectives of student loan schemes

Objective 1: Budgetary objectives (income generation)
- Income generation to maintain university enrolment levels and output/quality, in response to rising public university unit costs (additional government funding not available)
- Funding replacement: in response to reduction in overall government expenditures, including the education sector
- Funding replacement: in response to reallocation of public education budgets, from universities to sub-sectors with higher societal rates of return (e.g. basic education)

Objective 2: University system expansion
- Generation of additional revenues to (partially) finance expansion of the public university sector
- University expansion through growth of the private university sector (to minimize the state's role in financing expansion)

Objective 3: Social objectives (equity/access for the poor)
- Loans targeted on needy students
- Cross-subsidization: grants for needy students financed by income from higher fees

Objective 4: Manpower needs
- Meeting specific occupational/regional manpower needs

Objective 5: Student assistance
- Easing student financial difficulties during study
- Increasing student commitment
- Financial independence for students

It should be noted that loan schemes primarily concerned with cost recovery are also frequently subsidized and targeted on the poor. But these elements are not an integral part of a cost recovery loan scheme, which, in principle, should be offered at market interest rates and available to all, not only the poor. The availability of additional revenues from student fees, facilitated by the introduction of a loan scheme, may not lead to increases in net funding to the education institutions. Whether it does so or not will depend on whether additional revenues from fees are offset by commensurate reductions in public funding of the institutions.

Facilitating higher education expansion

Governments have responded to the growing social demand for higher education through policies leading to expanded student enrolments; yet, due to national budgetary constraints, the growth in student numbers is largely unmatched by commensurate additional government funding. Responding to the pressures of growing social demand for education expansion will require sizeable increases in public expenditures; these increases could be contained by offsetting additional revenues from increases in student fees, perhaps matched by reduced public institutional support.

A complementary measure is to encourage the growth of private educational institutions. Students pay full costs at private universities, with a minimal burden on the public purse. However, full-cost fees are likely to be sizeable and beyond the reach of large segments of the population. A student loan scheme may have a central role to play in easing the burden of private fees, particularly if private education is to be widely available and is not to remain the preserve of the rich. In Colombia and Brazil, for example, loans to students attending private institutions have permitted these institutions to expand, thus increasing the overall access to higher education while lowering budgetary demands on the government. The SOFES loan scheme in Mexico is directly targeted on academically able but financially needy students attending, or wishing to enrol in, private higher education institutions. This scheme receives considerable public subsidies; however, a student loan scheme introduced for this purpose does not, in principle, need to be a subsidized one.

Social objectives (increasing access for the poor)

None of the above reasons for introducing a student loan scheme constitutes a case for subsidized student loans. However, the widely held objective of increasing the educational participation of the poor does. In many countries the relatively low enrolment of poor and disadvantaged youth in non-compulsory education is a cause of social concern; increasing the access to schooling among these segments of the population has become a major element in educational and social policy. There is a broad consensus that clear financial incentives need to be offered, not only to overcome the burden of fee payments and living expenses but also to offset both parental resistance to reductions in family income and the risk that the benefits of the educational process may not be sizeable.

The traditional, and most effective, method of enhancing the educational access of the poor has been through the provision of means-tested grants (scholarships or bursaries) to cover tuition fees (where schooling is not free) and usually living expenses as well. This remains the dominant approach for secondary education, although there are exceptions in some countries; for example, Thailand provides student loans for upper-secondary students. However, a widespread scholarship scheme is likely to be expensive; the use of loans rather than grants offers a method that both increases access for the poor and reduces, or at least contains, public expenditure over the longer term, as loan repayments build up. To be effective in increasing the access to education of the poor, loans need to be offered with attractive conditions. Hence the justification for subsidized loans, in terms of grace periods for repayment, below-market rates of interest and repayments not fully linked to inflation.

A less direct role for student loans under this objective is the provision of grants for needy students, financed by income generated from (higher) tuition fee payments of more affluent students for whom non-subsidized loans are available (that is, at market or near-market interest rates).

Manpower needs

Loan schemes may aim specifically at providing support for students who are willing to study in fields of national manpower priority (for example, engineering) or to work in areas of social importance (for example, doctors or teachers serving remote rural areas). Loan schemes may be developed specially for these groups (such as medical students) or advantageous repayment conditions may be offered within the context of a general, non-subsidized loan programme.

Easing student financial burdens

The final group of objectives is more typical of loan schemes in developed countries. Even when tuition fees are minimal, students (including the more affluent as well as the poor) may face considerable financial burdens. Potential earnings are forgone while studying, and living expenses may be sizeable, especially when the student does not attend a local university. In many countries students are able to combine work with study: this may take the form of part-time, usually casual, student employment (on or off the campus), as in the US concept of ‘working your way through college’. In other cases, timetabling and university regulations facilitate regular employment with study. However, in some systems, these possibilities may not be readily available or it may not be the norm for students to work. In these cases, financial pressures, which may have negative effects on student academic performance, can be mitigated by the broad availability of student loans. While such burdens may fall relatively heavily on the poor, in principle loans for this purpose could be made available for all students, including more affluent as well as poor students, but not subsidized.

There are two additional arguments under this category of objectives which are often voiced: increasing student commitment and offering university-level students financial independence. Students, particularly from more affluent backgrounds, who benefit from overly subsidized university education, may not develop a sufficiently mature approach or commitment to studies without the discipline imposed by payment of realistic university fees; loan schemes render feasible the imposition, or augmentation, of tuition fees. Finally, it is argued that students who have reached adulthood should not be forced to rely upon parental financial support, which might not be forthcoming even in better off families.

Implications for the operation of loans scheme

These alternative objectives of national loan schemes, which will differ across countries, will carry implications for the general workings of these schemes. In this article we concentrate on five central aspects of the working of loan schemes: these concern the effect they will have on fee levels and university financing, on levels of loan subsidy, on the need for loan targeting and whether a government-sponsored loan scheme should be extended to students enrolled at private university institutions. Our analysis is summarized in Table 2.

University funding

We have noted that loan schemes are often introduced to facilitate tuition fee increases which, in turn, ease university financial burdens. Turning to columns I and II of Table 2, we see clearly that this will depend on the underlying objectives of the loan scheme. In about half of the cases, loan schemes are not seen as a vehicle for cost recovery and in only a minority of the cases is additional funding generated for university education.

Table 2
Alternative objectives of student loans: effects on the working of the scheme

	I to facilitate fee increases at public universities	II additional university funding generated	III effective loan recovery expected (i.e. subsidy is not justified)	IV target group defined	V loans to students in public or private university sector	VI examples of complementary policies or policy alternatives
Objective 1: Budgetary						
Revenue generation: rising public university unit costs	Yes	Yes	Yes	No	Public	Greater internal efficiency Other sources of income generation
Funding replacement: reduction in government expenditures	Yes	No	Yes	No	Public	As above
Funding replacement: reallocation of public educational budgets	Yes	No	Yes	No	Public	As above
Objective 2: University system expansion						
Revenue generation to fund public university expansion	Yes	Yes	Yes	No	Public	Other sources of income generation
Growth of the private university sector	No	Yes	Yes(?)	No	Private	Direct subsidy
Objective 3: Social – equity/access for the poor						
Loans targeted on needy students	No	No	No	Yes	Public and private	Scholarships for needy students
Cross-subsidization	Yes	Yes(?)	Yes	No	Public and private	Alternative sources of finance for grants to needy students

Table 2 (contd.)

	I to facilitate fee increases at public universities	II additional university funding generated	III effective loan recovery expected (i.e. subsidy is not justified)	IV target group defined	V loans to students in public or private university sector	VI examples of complementary policies or policy alternatives
Objective 4: Manpower needs						
Meet specific manpower needs	No	No	No	Yes (?)	Public and private	Other incentives e.g. income tax reductions, subsidized housing
Objective 5: Student assistance						
Ease student financial difficulties	No	No	Yes	No	Public and private	Opportunities for student employment Flexible study programmes
Increase student commitment	Yes	Yes	Yes	No	Public and private	Work-study and national service schemes
Financial independence	No	No	Yes	No	Public and private	Opportunities for student employment

Subsidized loans

There is much greater unity with regard to the need for government subsidy of loan schemes (column III). In most instances, there is no case for student loan subsidy; the aim should be full loan recovery. This is in strong contrast to the heavy subsidy in practice accorded to most student loan schemes, notably in developing countries. There is a clear case for subsidy only for loan schemes targeted on the poor and to meet manpower needs.

Any subsidy will result in only partial recouping of the original capital cost of the loans, overall. That part of the loan that is not repaid may be seen as a 'hidden grant' to the borrower, the size of which is a reflection of the degree of subsidy built into the scheme. In many loan schemes the hidden subsidy is substantial. Johnstone calculated the hidden subsidies involved in student loan schemes in Germany, Sweden and the USA in the 1980s (Johnstone, 1986: 168–1) and Ziderman and Albrecht calculated interest subsidies for over twenty student loan schemes in the 1980s and early 1990s and showed subsidies or hidden grants ranging from 13 per cent in Barbados to over 90 per cent in one student loan programme in Brazil (Ziderman and Albrecht, 1995: 70–71). In this sense, loans offered at commercial rates, on the one hand, and outright grants, on the other, might be seen as two extreme points on a continuum, with a subsidized loan lying somewhere in between. The larger the loan subsidy, the greater is the hidden grant element. From this arises a central policy issue: given the higher administrative costs of loans compared with grants and the probabilities of repayment default, at what level of subsidy does a grant become a more cost-effective instrument for helping the poor than a subsidized loan?

In principle, private sector student loans aimed at facilitating the growth of the private sector (and therefore the expansion of the university system) should not be subsidized. But in many countries, high tuition fee levels at private institutions may imply an overly heavy repayment burden in the case of full-cost, unsubsidized loans (particularly for less well-off students who are unable to gain entry to the prestigious public universities). In this case, the subsidizing of student loans in the private sector may remain a more cost-effective method of generating university expansion (through private university growth) than expanding public sector provision.

Targeting student loans

Targeting loans to particular categories of students is generally unnecessary, except in two cases (column IV). Loan schemes designed to assist the poor should be targeted to reach this population; otherwise, the central objective of the loan scheme will be compromised. Some prior screening of applicants for loans aimed at meeting manpower needs would enhance the efficacy of the scheme in encouraging students to enter employment in needed occupations and regional locations.

Loans for public or private sector students?
Finally, we note that loans for objectives 1 and 2 should be restricted to students enrolled in public universities (except for those loans aimed specifically at private university students). However, in meeting the remaining three objectives, loans should be available to students in the public and private sectors, on an equal basis.

Evaluating loan schemes: meeting defined objectives

The preceding discussion carries important implications for loan scheme evaluation. There can be no standard approach to evaluating the efficacy of individual loan schemes. A given student loan scheme will need to be evaluated in the context of the central objective(s) that it is designed to achieve. For objectives 1 and 2, the most relevant form of evaluation is a financial appraisal of the scheme – in particular, to probe the level of loan recovery achieved by the scheme. For example, a recent evaluation of the student loan scheme in Thailand, which offers loans to students in upper secondary school as well as higher education (Ziderman, 2002), was of this type. In contrast, loan schemes with equity objectives, aimed at increasing university access for the poor, should be evaluated primarily in terms of their success in reaching these populations and of how far the availability of loans results in raising the higher education participation of the poor. An earlier evaluation of the loan scheme in Thailand (Ziderman, 1999) focused on this aspect of the Thai scheme. The test of the efficacy of loan schemes with manpower needs objectives lies in their success in encouraging students to enrol in these priority areas of study and, subsequently, to enter employment in these fields. Loan schemes with student assistance objectives (objective 5) will probably need to be appraised by survey methods aimed at eliciting information on the easing of student financial burdens and enhanced commitment.

Loan scheme evaluations can provide information on the degree of success achieved in meeting set objectives. This must be set against both the costs of operating the loan scheme (the extent of loans subsidy) and the possibility of employing alternative policies (as listed in column VI) to achieve these same objectives.

Notes

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[1] Incidentally, the introduction of a regime of sizeable student fees will have additional, positive, effects on the education system: it leads to a changed relationship between institution and students, in the direction of a provider–client relationship, more inter-university competition and calls for a greater student voice in the affairs of the institution.

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