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*Establishing Student Loans in Developing  
Countries: Some Guidelines*

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**ESTABLISHING STUDENT LOANS IN DEVELOPING COUNTRIES:  
SOME GUIDELINES**

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## Abstract

This is a practical guide addressed to the policy maker in a developing country who contemplates the introduction of a student loan scheme. The paper considers the choices available in this respect and the evidence on the advantages and disadvantages of different models. It is concluded that no "ideal" student loan model exists for the simple reason that the choice between alternatives depends on the conditions in a particular country.

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Maureen Woodhall

ESTABLISHING STUDENT LOANS IN DEVELOPING COUNTRIES:  
SOME GUIDELINES

Introduction: International Experience with Student Loans

Student loans are already widely used as a means of financing higher education in both developed and developing countries. Government sponsored or guaranteed student loan programs, which enable students to borrow to finance tuition fees or living expenses, now exist in well over thirty countries (Woodhall 1983). The first official loan schemes were set up in Europe, USA, and Latin America in the 1950's and 1960's, and many new schemes have been set up in the 1970's and 1980's. In some cases the introduction or expansion of a loan program has been financed by development aid. USAID provided financial assistance for some loan programs in Latin America in the 1970's and the Inter-American Development Bank (IDB) has financed loan programs in several countries in Latin America and the Caribbean.

With more than thirty countries providing student loans, and with several countries offering more than one type of loan, there is a bewildering variety of models and an even greater multiplicity of variables to consider in designing a loan program.

The purpose of this study is to examine the range of choices facing policy makers who are convinced of the advantages of establishing some sort of loan program but is unsure of the advantages or disadvantages of different types of loan scheme.

The focus is on practical choices rather than on the theoretical case for introducing loans. It is written to provide practical assistance for a politician or policy maker, who is willing to embark on the process of establishing a loan program, or at least willing to undertake an experiment or pilot project, but unsure what prior decisions and choices have to be made, before a loan program can be set up. The paper considers the choices facing the policy maker, in terms of ten crucial decisions that have to be made, and the evidence that is available on the advantages and disadvantages of different models.

There is no single "ideal model" put forward in this study, for the simple reason that the choice between alternatives depends on the conditions within the country, the existing pattern of finance for higher education and the aims of the policy maker in modifying the existing system and introducing loans. In other words, it depends on objectives and priorities. In some countries, the aim of a loan program is to expand financial aid for students; in other cases the aim is to reduce the level of subsidy and substitute loans for grants, scholarships or bursaries. What will work in one situation will not necessarily work in another country, facing different economic and political conditions. It is hoped that this will nevertheless prove useful, if only as a "check list" of problems to be solved, before a student loan program can be established.

### Policy Choices

A policy maker who favours the idea of student loans, but is still at the stage of designing a loan program, faces a number of policy decisions. First and foremost:

What is the aim of the loan program? Student loans may be introduced as a way of increasing opportunities for access to higher education, by providing subsidies or as a way of generating extra resources for higher education by increasing cost recovery. The goals of the loan program must be clarified at the outset. The aims of the loan program will be partly determined by the choices already made regarding fees:

What is the policy on fees? Do universities and other institutions charge fees for tuition and for accommodation and food? The scope of any student aid program will depend on whether students are expected to pay fees in public universities and colleges, whether private institutions are permitted, and whether financial aid is made available to students in both the public and private sector.

Finally the various options in the design of a loan program can be summarized in terms of ten practical decisions that have to be made:

1. What form will student financial aid take? Will all aid be provided as a loan or will grants, scholarships or other forms of aid also be available? What will be the relationship between student loans and other forms of aid?
2. Who will administer the loan program? Will it be the responsibility of banks, or of universities and colleges, or will a new agency such as a state-owned student loan fund be established?
3. Who will be eligible for loans? What criteria will be used to select eligible students?
4. What proportion of students will receive loans?
5. What size of loan will be provided? What will be the average and maximum annual loan, and total borrowing limit?
6. What will be the loan repayment terms? What will be the interest rate and the length of repayment?
7. How much debt should students be allowed to accumulate? Will provisions be made to ensure that students do not face an unacceptable burden of debt, or to reduce the burden of debt in particular circumstances?
8. How will loan repayments be collected? What measures are necessary to keep default to a minimum?
9. Will the loan scheme incorporate incentives? Will loans be used to provide incentives for particular categories of student or to influence student behavior and choice?
10. How much flexibility will be built into the loan program? Will there be special provisions for women, or for those who study abroad?

## Policy Options in Designing a Student Loan Programme

### 1. Type and Mix of Financial Aid for Students

Very few countries rely exclusively on loans as a means of financial aid for students. Most countries rely on a variety of ways of financing students including:

- (a) Grants, Scholarships or Bursaries which may be awarded:  
to all students, regardless of their individual circumstances,  
on the basis of financial need,  
on the basis of academic merit
- (b) Bonded Scholarships or Bursaries which may be awarded to students in particular fields, for example, teacher training, medicine, or engineering.
- (c) Sponsorship by Public or Private Employers
- (d) Subsidized Services for Students for example, low-cost housing or subsidized meals.
- (e) Subsidized Job Opportunities for Students.
- (f) Tax Concessions for Private Educational Expenditure.
- (g) Subsidized Student Loans which may offer varying degrees of interest subsidy, long repayment periods and in some cases, loan forgiveness clauses".
- (h) Unsubsidized Student Loans which may be offered by commercial banks at market interest rates.

The policy maker should consider alternative combinations of grants, loans, interest subsidies and other forms of financial aid, and choose the most cost-effective combination, taking into account:

\*the objectives of student aid policy. If priority is to be given to rewarding academic merit, then a competitive scholarship program would best meet this goal. If satisfying manpower goals, is the main objective, then bonded scholarships may be appropriate, but if the purpose of aid is primarily to achieve equality of opportunity by removing financial obstacles, then means-tested grants or bursaries would have the



greatest impact. If on the other hand the aim is to introduce or increase cost recovery, then loans would be preferable grants. In fact most student aid programs are intended to meet a number of different objectives within a total budget constraint. The optimum mix of grants, loans and other forms of subsidy will therefore depend on:

- \*the relative costs of different forms of financial aid, including , administrative costs and "hidden costs", such as the costs of subsidizing loans or the costs of loan defaults, as well as direct expenditure on student aid. Finally it is important to consider :
  
- \*the political, administrative and other factors which may determine the feasibility of alternative options.

There are certain principles which can guide the politician or policy maker in choosing between alternative combinations of grants, loans and other subsidies.

(a) Education is both a social and private investment.

The way in which the burden of financing that investment is shared between individual students, their families, employers and taxpayers should take account of:

- \*who benefits from the investment
- \*alternative uses of public funds for subsidizing other forms of investment
- \*access to credit, which would enable individuals to finance profitable investment in education or training by borrowing.

(b) Subsidies for education should be provided to prevent underinvestment.

The level of subsidy should be sufficient to ensure adequate investment, taking account of social, as well as private benefits. But if the level of subsidy is higher than is necessary to allow for the external benefits of education then this will result in :

- \*high private rates of return, which in turn may lead to:
- \*excess demand for education, resulting in unemployment of graduates and school leavers or
- \*transfer of income from taxpayers to educated individuals.

Loans involve less subsidy than grants or scholarships, and for a given outlay, more students can receive loans, than grants. It is likely to be more efficient, therefore, when public funds are scarce, to provide financial aid in the form of a mixture of grants and loans than to rely only on grants. (see Annex 1).

(c) "Open" subsidies are more efficient than "hidden subsidies".

Most loan programs involve some form of subsidy, in the form of low interest rates, long repayment periods and cancellations of debt for certain categories of students. This means that all subsidized loans involve a substantial "hidden grant", since the present value of loan repayments, at low or zero rates of interest, will be less than the amount originally borrowed. (see Annex 2).

Interest subsidies for student loans are often an effective way of generating private capital for educational investment, at a fairly low cost to public funds. However, in general, it is desirable for students and taxpayers, as well as student loan administrators, to be fully aware of the extent of interest subsidies, which should not be treated simply as "hidden grants."

(d) Student aid programs should be carefully monitored to ensure that subsidies are allocated effectively.

If means-tested grants or interest subsidies are provided, it is important to ensure that the system is carefully monitored, so that subsidies are given only to those with genuine financial need. If bonded scholarships, or loan forgiveness clauses are used to attract students to particular occupations, it is important to ensure that this is an effective method of recruitment. Means-testing and other eligibility criteria will be discussed in more detail later in the study, but it should be remembered that the

choice of an appropriate type of financial aid will often depend on the administrator's ability to monitor its effectiveness.

(e) The objectives of student aid programs should be clear and explicit.

Student aid programs often try to meet a variety of objectives, including:

- \*help to satisfy demand for educated manpower
- \*provide financial assistance for low-income students
- \*encourage academic achievement.

It will be impossible to monitor the effectiveness of student loans or grants unless the objectives of the programs are stated clearly and explicitly.

These general principles suggest that the most cost-effective mix of financial aid for students in a developing country will include:

- \*means-tested grants for students with greatest financial need
- \*subsidized loans for other low-income students
- \*loans at a higher interest rate for more affluent students
- \*bonded scholarships or an element of loan forgiveness to attract students to particular occupations, such as teaching

The actual combination of loans, scholarships and grants should take account of:

- \*methods of determining eligibility
- \*the costs of administration
- \*loan repayment terms
- \*the expected level of default

All these factors will be discussed in the remainder of this paper.

## 2. Administration of Student Loans

Any government establishing a loan program with government guarantees, interest subsidies or direct provision of loans will need to set up a planning committee, including representatives of:

- \* The Central Planning Ministry (if such exists)
- \* The Finance Ministry
- \* The Central Bank
- \* The Ministry of Education
- \* Universities, Colleges or other relevant institutions

This planning committee is likely to have over-all responsibility for designing the loan program. Before deciding on the terms of loans to be offered, it will be necessary to decide:

- \* Who will have direct responsibility for administering the loan program?
- \* Who will be responsible for selecting loan recipients, administering means tests or applying other criteria?
- \* Who will actually provide loans for students?
- \* What form of guarantee will be provided or required?
- \* Who will be responsible for collecting loan repayments.

Day-to-day responsibility for administering the loan program may be given to:

- \* a government agency set up for the purpose, such as the Central Study Assistance Committee in Sweden, the Joint Committee on Student Finance (JCSF) in Hong Kong, the Students' Loan Bureau in Jamaica.
- \* a quasi-government agency, such as the Japan Scholarship Foundation
- \* a government agency with other financial responsibilities, such as the Pakistan Banking Council
- \* state-owned commercial banks, such as the People's Bank in Sri Lanka, the Bank Negara Indonesia 1946, in Indonesia
- \* private commercial banks, backed by a government guarantee, as in the Guaranteed Student Loan Program in the USA, the Canada Student Loans Plan
- \* universities, colleges and other education institutions, as in the National Direct Student Loan Program in the USA
- \* student welfare organisations, such as "studentwerke" in the Federal Republic of Germany.

Different models have their own strengths and weaknesses. Commercial banks may have considerable expertise in the management of loans, and collection of repayments, but little knowledge of the education system. University teachers may be very well equipped to make academic judgements but less experienced in judging financial need and not at all experienced in administering and controlling loans. A highly centralized system may have lower costs than a more decentralized system, but also be much less flexible.

In choosing between alternative administrative models, the policy maker must take account of the likely costs and efficiency of the different options, as well as the capacities of existing institutions. If there is a well developed banking system, then expertise in loan management should be tapped wherever possible. But in developing countries, which do not have a vast network of private banking and financial institutions, special agencies may have to be established, or responsibility for loans may be given to a state-owned bank. The choice between setting up a specialised agency, using state-owned or commercial banks, will depend on:

- \* the structure of financial institutions in the country, their responsibilities, coverage and location, and experience in administering loan programs
- \* the relative costs of setting up a new agency or using existing financial institutions
- \* the special requirements of external agencies such as international development banks, which may be involved in financing a student loan program, and may wish to establish special procedures for ensuring adequate financial control and monitoring

Countries such as Jamaica, and Barbados, which established student loan programs with the help of the Inter-American Development Bank (IDB) have set up specialized agencies, in the belief that this would be the most efficient means of administering loans, and in order to comply with IDB requirements for control and monitoring of the loan program. (see Annex 3).

However, in many countries it may be cheaper and more effective to give responsibility for day-to-day administration to existing banks which already

operate loan programs. For example, in Indonesia, responsibility for the student loan program, Kredit Mahasiswa Indonesia (KMI) was given to the largest state-owned commercial bank, Bank Negara Indonesia (BNI) 1946, which already had responsibility for administering other government credit programs such as loans for industry and agriculture. BNI 1946 already had considerable experience in managing loan programs, but no knowledge of how to select the most "deserving students". Responsibility for selecting loan recipients was therefore delegated to the Rectors of individual universities, which helps to reduce the direct costs of administering student loans, but at the expense of increasing the administrative burdens of universities.

The choice of administrative model should take account of whether existing banks or other financial institutions have the capacity to run a student loan program. If not, a special agency should be established, but in either case the loan administrators should work closely with educational institutions.

A further choice has to be made about how what form of guarantee will be provided for the loans. The options are :

- \* the government guarantees the loan against default or non-repayment of the loan due to illness or death, which is a common pattern in many countries
- \* the loans are insured with a government-backed insurance agency, as in Indonesia
- \* the loans are guaranteed by specially established guarantee agencies, eg. the guarantee agencies set up by the governments in the USA (See Annex 4)
- \* borrowers must provide personal guarantees eg. a relative who will be personally responsible for the loan in cases of default.

The choice will depend partly on whether a government-backed insurance agency already exists to provide other forms of loan guarantee. If borrowers are required to provide their own personal guarantees, this may discourage students from the poorest families. The government provides the ultimate guarantee against default in all subsidized loan programs, so that the simplest option for most developing countries is for the government to guarantee student loans directly.

### 3. Eligibility for Loans

One of the first decisions in designing a student loan program, is whether it should be:

- \* available to all students who wish to borrow
- \* selective, and confined to particular categories of student

If the scheme is selective, the basis of selecting loan recipients may be:

- \* academic merit
- \* financial need
- \* a combination of both merit and need

In some countries scholarships are awarded on the basis of academic merit, and loans are provided on the basis of financial need. However, most loan programs involve some element of subsidy, either by means of interest subsidy, or cancellation of debt in certain circumstances. At a time of increasing pressure on public funds most countries are therefore obliged to ration subsidized loans, and make both loans, and grants or scholarships, dependent on financial need.

The choice of eligibility criteria may involve a conflict between efficiency and equity objectives. For example, in several programs loans are given only to students in public universities, on the ground that the quality of private universities is variable and inferior to public universities. On the other hand, in most countries, students in public universities already enjoy subsidized tuition so that these students enjoy a double advantage, compared to students in private universities, who must finance fees as well as living expenses. In Indonesia, for example, a recent survey showed that students in public and private universities had very similar family income levels. But students in public universities paid substantially lower fees than students in private universities, and were eligible for student loans, whereas students in private universities were not. This helps to keep down the costs of the student loan program, but raises serious issues of equity. The decision to opt for a highly selective loan program may have undesirable equity implications, in the sense that access to subsidized loans is confined to a particularly privileged group of

students, who already enjoy large subsidies in the form of low tuition fees. On the other hand, the alternative option of an "open-ended" program will impose considerable extra costs, while a program based entirely on financial need may have higher drop-out rates than a program confined to academically strong students.

In determining the criteria for eligibility for loans, the policy-maker should consider both:

- \* the need to select loan recipients who are likely to succeed in their studies -an efficiency criterion-
- \* the financial need of applicants - an equity criterion-

The selection of students who meet the academic criterion is usually left to the staff of universities, colleges or other educational institutions. Academic staff are probably best equipped to judge whether a student is likely to complete his/her studies successfully and most student loan programs require that borrowers maintain "satisfactory academic progress."

The question of how to administer a means test, or to determine "financial need" is more difficult. If the policy maker decides to take family income into account, in determining eligibility for grants or subsidized loans, one option is to adopt a "sliding scale" which calculates the expected "parental contribution" to the costs of higher education, and then provides loans or grants to cover the difference between the assumed parental contribution and the actual costs of study.

In developing countries the administration of a means test may present considerable problems, because of the lack of accurate data on family incomes, the absence of an established method of calculating family income for income tax purposes, particularly in the case of the self-employed, or those working in the agricultural or informal sectors of the economy. In general, an effective means test, or test of financial need, requires information on:

- \* earned income within the family
- \* non-earned income
- \* assets such as property or land ownership



- \* number of dependent children
- \* special circumstances (eg. unemployment or illness)

In Latin America some educational institutions apply a "sliding scale" of fees, which requires detailed information about family income. In Peru, for example, universities change differential fees according to a student's family income level, which is judged on the basis of:

- \* parents' earnings
- \* assets such as land, property, bank accounts, savings etc.
- \* number of dependents

In order to estimate a student's "ability to pay", university staff require extensive information about family income, which is collected in a personal interview with students and their parents. In these interviews students and parents must answer questions about ownership of assets such as a house, or car, as well as about parents' jobs and earnings. Admittedly, such questions provide only a very rough picture of family income level but it may help to supplement information provided on an application form to determine eligibility for grants, loans or reductions in tuition fees.

Some countries, use very detailed tests of family income and "ability to pay" (See Annex 5). This may provide detailed and accurate information about family incomes, but the administrator must always consider the trade-off between detailed, accurate information and the costs of collection and verification of information. (see Annex 5).

#### 4. Number and Proportion of Students Receiving Loans

One of the crucial decisions to be made in designing any system of student support is the scale of the program, as measured by the number and proportion of students who benefit. The number of grants or loans awarded each year will obviously depend on the size of the country, its wealth, and the structure and finance of higher education.

Decisions about the proportion of students who can be given financial assistance depend partly on the wealth of the country, but should also be

linked with policies on fees. Where students are expected to pay fees for tuition or for board and lodging, there is a more obvious need for a program of financial assistance than in countries where fees are minimal and institutions highly subsidized. On the other hand, some developing countries, for example in Africa, which provide free tuition also give generous scholarships or grants to all students, thus considerably increasing the public costs of higher education.

In determining the size of a loan program, the planner should consider:

- \* the number and proportion of the age group who participate in higher education
- \* the criteria for eligibility; ie. is selection on the basis of merit or financial need?
- \* the level of tuition and other fees
- \* availability of other forms of financial assistance

A country which already provides a high degree of subsidy in the form of low or zero tuition fees and scholarships or stipends for all students, could reduce public expenditure in the long run by introducing a loan scheme to replace scholarships and stipends. However the extent of the saving would depend on the cost of education, the terms of the loans and the success in securing repayment. For example, a recent World Bank study (Mingat and Tan 1986) showed that if all students received a loan which was repaid over 10 years, and loan repayments equalled 5% of graduate's average income, the proportion of university costs which could be recovered by means of loan repayments would vary between 16% in a typical country in Anglophone Africa, 36% in Francophone Africa and over 40% in Latin America. These differences reflect differences in the costs of higher education and in average graduate salaries. In such a situation the introduction of a loan program would mean a reduction in public subsidies for higher education, even if all students receive a loan.

##### 5. Size of Loans

In determining the size of the loans to be made available to students, the planner must consider:

- \* the average costs of higher education to the individual student, i.e. tuition costs, books educational materials, living expenses and travel; which of these items of cost will be covered by the loan ?
- \* variations in costs, particularly the differences between public and private universities or colleges, and between different levels and subjects within these institutions
- \* the length of course
- \* other sources of financial aid
- \* opportunities for part-time employment

In the light of these factors, the planner must determine:

- \* the average loan per student
- \* the maximum loan per year
- \* the maximum permitted debt

Many student loan agencies conduct regular surveys of student expenditure, in order to determine the size of loans in relation to what students actually spend. In other cases, the size of loan is fixed with reference to a "typical budget", which is drawn up in consultation with university authorities. In developing countries this may be simpler than attempting a detailed survey of what students actually spend, but it is important to ensure that the "typical budget" is realistic.

Setting the maximum size of loan needs to take account of actual levels of student expenditure, and also what is regarded as a "manageable" debt, i.e. a debt which can be repaid without imposing excessive burdens on borrowers, which could either lead to high rates of default, or to distortions in the future spending of graduates.

What is a "manageable debt" for student borrowers? Answers vary between countries, and depend partly on the level and pattern of graduates' expected earnings, and partly on what students and society regard as a "reasonable" level of debt. A rough yardstick, used in several countries, is that loan repayments should not exceed 8 to 10% of a graduate's income, and that this should determine the maximum debt that students may incur. However, the borrowing limits, which determine the maximum size of loan, will also be dependant on two related policy decisions:

- \* What are the repayment terms for the loans?
- \* Are the repayment terms sufficiently flexible to ensure that students do not face an unacceptable burden of debt?

## 6. Repayment Terms

The choice of repayment terms actually depend on a series of decisions:

- a) What rate of interest will be charged?

Should student borrowers pay interest which reflects market rates of interest, or will the government subsidize the interest on student loans? Most loan programs provide some interest subsidy, which as Annex 2 showed, is equivalent to providing a grant, since it means that the borrower is not repaying the real value of the loan, taking account of alternative interest rates.

Rates of interest on student loans vary enormously. There are a few cases of interest-free loans, for example in Hong Kong, and in Pakistan, the fact that the Islamic religion is opposed to the concept of interest or usury means that no interest is charged. On the other hand the ICETEX loan program in Colombia now charges 25%, which reflects the very high rates of inflation in Latin America. In principle a rate of interest close to the market interest rate will impose much less burden on government funds, and be more efficient than a highly subsidized interest rate. However it will also impose a greater burden on borrowers, unless there is provision for those with low incomes to pay a lower rate of interest. In developing countries, where budget constraints are severe, and graduates often enjoy considerable earnings differentials compared with secondary school leavers, there is a strong case for charging interest of at least 6-8%, but at the same time ensuring more favorable or flexible repayment terms for students from low-income families, or for graduates who are unemployed. (see Annex 6).

b) What "grace period" will be allowed?

Most loan programs allow a "grace period" which is intended to give newly qualified graduates a period in which they can find a job and establish themselves in regular employment, before they are required to repay their loan. One problem in many developing countries in recent years is an increase in the "waiting period" before graduates find their first job. If the "grace period" is not increased, to take account of the difficulty of finding employment it is likely to lead to high rates of default. On the other hand, if interest rates on student loans are low, a longer grace period will increase the costs of the interest subsidy. The best policy is therefore likely to be to combine a higher interest rate (perhaps 8 to 10% ) with a more generous grace period, which takes account of the actual "waiting period" facing graduates.

c) What is the length of repayment period?

The length of repayment in existing loan programs varies from four or five years to 20 years or more. Not only does the length of repayment vary considerably in different programs, but there are also variations in the degree of flexibility. One option, adopted in several countries, is to make the length of repayment dependent on the size of a student's debt, on graduation. In Sri Lanka, for example, the length of repayment of loans offered by the People's Bank, under the University Student's Loan Fund Act of 1972 varies from 2 to 5 years, according to the size of a graduate's debt.

The alternative is to set a fixed length of repayment period. Some Latin American programs require borrowers to repay their loans in the same period of time as their length of study, which means that a graduate, after a 3 or 4 year university course, must repay the loan in 3 or 4 years. A repayment period of 10 years is fairly typical, and is likely to prove reasonable in most developing countries.

d) Is the loan to be repaid in equal instalments, or can they be varied, according to a graduate's income?

Some countries have introduced variable repayment schedules, in an attempt to spread the burden of repayment more evenly over the graduate's working life. Graduate earnings generally rise with age so that repayments in equal instalments will represent a much heavier burden in the early years than in the later years. On the other hand, if instalments rise with age, the repayment burden will be equalised over the life of the loan.

An alternative option is an "income-contingent" loan, which means that loan repayments vary with a graduate's income and students undertake to repay their loans by means of a fixed proportion of their income or earnings, so that graduates with high earnings repay their loans more quickly than those in low paid occupations. This has been proposed, in several countries, but so far there have been very few examples of truly income-contingent loans. In a developing country income contingent loans are likely to be difficult and expensive to administer. However it is important to ensure that those with low incomes can reduce their burden of debt by extending the repayment period rather than simply defaulting on repayment.

In determining the terms of repayment the planner must take account of:

- \* the costs to the government of alternative rates of interest subsidy
- \* the burden of debt facing borrowers
- \* the likely rate of default if repayment terms are too "harsh"

There will inevitably be certain trade-offs to be considered. For example, generous repayment terms may make it much easier to introduce a loan scheme for the first time, but will increase the costs to the government. An increase in the interest rate or a reduction in the length of repayment or grace period may generate a saving of public funds, but it may simply increase the rate of default.

In designing a loan program, therefore, an administrator needs to estimate the costs of alternative levels of subsidy which result from different interest rates and different repayment terms. A computable model, such as is illustrated in Annex 7, should be developed to examine the

effects of alternative repayment terms and other variables which together determine the burden of debt facing a graduate who has financed higher education by means of a loan.

## 7. The Burden of Debt

Under what circumstances may borrowers postpone repayment? Some loan programs are particularly concerned to ensure that the burden of debt does not impose financial hardship on graduates who are repaying their loans, while others are more concerned with cost recovery. One option is to stipulate that graduates must apply to the bank or loan agency, in cases of financial hardship, in which case the question is what constitutes "hardship".

Any definition of "financial hardship" raises the question of how much of a graduate's income should be devoted to loan repayments. Borrowing limits that ensure that, on the basis of current wage and salary levels, graduates will not have to devote more than 10% of their future income to repaying their loans are generally regarded as reasonable in many countries. Some people have suggested that 10% is too high a figure and that graduates cannot reasonably be expected to spend more than 6 to 8% of their income on student loan repayments, particularly since the repayment period is a time when many graduates will be getting married, having children and setting up home for the first time. On the other hand, others argue that graduates can be expected to set aside more than 10% of their incomes to repay student loans, particularly if there is a substantial difference between graduate and non-graduate earnings. There is no general agreement about what is "manageable" or excessive debt but a reasonable yardstick is that loan repayments should not exceed 10% of a graduate's gross income. (see Annex 8).

If this is taken as a rough yardstick for determining "reasonable" levels of debt, expansion of loan programs would appear feasible in many countries. For example in Hong Kong the Director of Audit estimated in 1985 that under the existing scheme, under which students receive a loan-plus-grant, loan repayments require 6 or 7% of the average starting salary of a university graduate, and suggested that all grants should be replaced by loans. (see Annex 9)

## 8. Procedures for Collecting Loan Repayments

How can a planner ensure that loan collection is effective? Critics of student loans frequently suggest that it will prove difficult, particularly in developing countries, to secure repayment of loans and prevent default, ie failure to repay the loan. Certainly inadequate collection procedures have proved to be a weakness of some student loan programs, but in other countries banks or loan agencies have proved quite successful in collecting loan repayments and maintaining low levels of default.

Success seems to depend crucially on the attitude of banks or loan agencies. If the banks administering student loans appear to make few efforts to prevent default, then borrowers are far more likely to let their repayments fall into arrears or fail to make repayments, than if the agencies or banks show themselves to be strongly committed to loan collection. If banks can easily declare a loan to be in default and claim the full value of the loan from the government or guarantee agency, then they will have little incentive to improve loan collection procedures. (see Annex 10).

Experience shows that default rates have been reduced and maintained at a low level in some countries. For example in Japan, efforts to improve collection procedures have included:

- \* introducing new methods of repayment, which make it simpler for borrowers to pay their regular installments, for example by bank standing orders, direct deductions from salary by employers etc.
- \* asking universities to help trace missing students
- \* rescheduling debts for borrowers facing temporary difficulties
- \* sending all borrowers a newsletter with information about the loan program and a list of defaulters
- \* prosecuting persistent defaulters

The success of these efforts has markedly increased the rate of recovery of student loans in Japan from only about 53% in the mid 1950's to 95% in the mid 1970's and 97% in 1985. In USA, also, experience shows that default rates can be reduced when banks and guarantee agencies improve collection procedures. (see Annex 11).



The necessary steps for ensuring efficient collection of loan repayments include:

- \* Simple but effective mechanisms by which borrowers can make repayments: the simplest may be to use the income tax collection system, although very few countries have so far attempted this. An alternative is to ask employers to deduct loan repayments from employees' salaries. This may be easier in countries where a high proportion of graduates are employed in the public sector.
- \* Efficient systems of record-keeping, particularly of change of address. Large scale loan programs rely heavily on computerised records. In developing countries employers' records may be utilised, and several countries, require employers to inform the loan agency of any employee who has an outstanding loan.
- \* Determined efforts to pursue defaulters, and if necessary prosecute: or incorporate penalties for late payment.
- \* Widespread publicity, at the launch of the loans program, to ensure that students understand, and accept, their obligation to repay.
- \* Possibilities for postponement in the case of genuine hardship: few countries can afford the Swedish system of automatic postponement for those on low incomes, but borrowers are more likely to accept the obligation to repay if they know that cases of genuine hardship will be considered sympathetically.

It is clear that there are many factors including deep-rooted cultural influences, which may help to determine success in securing loan repayments. Although some loan programs have certainly encountered problems with defaulters, nevertheless experience shows that the majority of borrowers do repay their loans provided the banks or loan agencies demonstrate that the obligation to repay must be taken seriously.

## 9. The use of Incentives

A number of loan programs incorporate incentives to students to complete their studies in minimum time, to achieve high marks or to enter particular occupations. For example, in Barbados students receive "loan-grants", and the proportion of their loans to be repaid depends on their performance. Those who complete successfully, in the "normal" time, have up to 20% of their loan converted to a grant. Those who achieve high grades also have part of their loan converted to a grant. In such a scheme loans are regarded as a way to increase student motivation, in addition to their function of providing financial assistance for the needy.

Cancellations of part of a graduate's debt if he or she works in a particular shortage occupation is an alternative option to the "bonded scholarships" which are offered in some countries to attract teachers or other public servants. Several countries offer bonded scholarships which must be repaid if a graduate does not enter or remain in the particular occupation for which he or she was trained. Enforcement on this may, in some cases, be just as difficult as enforcement of loan repayment. One problem with bonded scholarships is that they quickly create the expectation that students will be guaranteed employment after graduation. Such an expectation may be realistic when a program is first introduced, at a time of manpower shortage, but difficult to change when labour market conditions change and shortages are transformed to surpluses. For example, in Egypt a guaranteed employment scheme for graduates was introduced on an experimental basis in 1963, and made permanent in 1973. Critics argue that this system is responsible for excess demand for higher education in Egypt and inefficiencies in the labour market, particularly in the public sector.

This illustrates the danger of a system of incentives, introduced at a time of labour shortage, which may, in time, give rise to the opposite phenomenon of a labour surplus. Any system of employment incentives introduced into a loan program should be sufficiently flexible to ensure that it can be withdrawn when labour market conditions change. This requires:

\* careful monitoring, to compare students with loans and those without,

- in order to assess the effectiveness of loan forgiveness clauses.
- \* careful comparison of loan forgiveness clauses with alternative options, for example direct increases in salaries of graduates in shortage occupations to compare their cost-effectiveness.

#### 10. The Flexibility of Student Loans

Given the large number of variables in a student loan program, it is clear that loans are potentially a very flexible instrument. Many programs offer flexibility of repayment terms for particular categories of student eg.:

- \* married women, who may be allowed to postpone repayment while they are looking after children
- \* students who study abroad and thus incur large debts, who may be allowed a longer period of repayment.

However some loan programs are designed to be even more flexible. For example, the idea of a "loan-grant", as it has been developed in Barbados, deliberately sets out to maximise flexibility, and use variations in the proportion of loan that must be repaid as a policy instrument, to reward those who achieve high marks or who enter particular occupations. Another example is the loan-bursary scheme in Lesotho, the main objective of which is to provide skilled manpower for the economy, particularly for the public sector. This is reflected in the loan repayment terms: If the borrower works in Lesotho for a minimum of five years after graduation, then 50% of the loan is transformed into a bursary; if the graduate works in the private sector, then a higher proportion of the loan (65%) must be repaid, and those who choose not to work in Lesotho are expected to repay all their loan. (see Annex 12).

However attempts to incorporate flexibility in this way raise a number of questions :

- \* How effective is the system for monitoring borrowers' future careers, and for enforcing different rates of repayment? For example, in Lesotho the fact that graduates in the private sector have to repay a

higher percentage of their debt may mean that it is more difficult to secure repayment, since it will often be more difficult to trace graduates in the private than in the public sector. Similarly, those who work abroad may be the most difficult to trace, but in Lesotho these borrowers must repay 100% of their loan. This clause may therefore be very difficult to enforce.

- \* What will be the cost implications of increasing flexibility? A scheme which incorporates large numbers of variable factors will be more difficult and costly to administer than a simpler program.

### Developing a Computer Model of a Student Loan Program

The study has shown that the design of a student loan program needs to take account of a wide range of variables. The capital required to establish a loan fund and the annual operating costs will depend on the choices made between the alternatives outlined above. In order to examine the cost implications of alternative choices, a computer program should be developed, which would show the effects of different choices.

One such model has been developed in the USA by the Educational Testing Service at Princeton, to allow student aid administrators to advise students on the implications of alternative decisions about how much to borrow. (The Student Loan Counselor Model). This model has been designed for use on a micro-computer. A similar model could be developed to help the loan administrator to design a loan program.

The purpose of such a model would be to show the effect of alternative parameters or variables which would determine the financial flows of the loan program variables which include:

- \* the number of loans awarded per year (expressed in absolute terms) or as a percentage of the total numbers in higher education
- \* the average period of the loan, (in years ) which will be dependent on the average length of study, and whether students can borrow for the whole period of study, or only for part of their course,
- \* the average size of loan per year

- \* the repayment period (in years )
- \* the "grace period", during which borrowers are exempt from paying interest and/or capital
- \* the interest rate

These all represent choices which the planner faces in designing a loan program. In addition it will be necessary to make assumptions concerning:

- \* the rate of default (ie. the proportion of borrowers who are in arrears with loan repayments or who do not make repayments, per year)
- \* the rate of inflation
- \* market interest rates.

The key features of a simple model is shown in Annex 1 which would allow the policy-maker to see the effects of alternative choices and assumptions on:

- \* the total number of loans awarded each year
- \* the total value of outstanding loans
- \* the amount received each year in loan repayments
- \* the cost of the interest subsidy.

A model of this type would allow the planner to analyse the implications of changing the terms of the loan, for example the rate of interest or the repayment period, or adopting different assumptions regarding the rate of default. Such a model, which could be designed for a main-frame or micro-computer, could be a valuable tool for the planner who wishes to explore the implications of alternative decisions.

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ANNEX 1

The Costs of Alternative Combinations of Loans  
and Grants

Student aid in Canada is provided through a mixture of loans, subsidized and guaranteed by the federal government (the Canada Student Loan Program, CSLP), grants financed by provincial governments and loans subsidized and guaranteed by provincial governments. Total government expenditure in 1979-80 was Canadian \$280 million, which provided grants for 20% and loans for 30% of all full-time students. The full cost of the grants was met from provincial government funds, but in the case of loans, the cost to government funds was confined to:

- \*interest subsidies,
- \*loan remissions for selected students,
- \*loan defaults, in the case of students unable to repay their loans because of illness, unemployment or financial hardship,
- \*administrative costs.

This resulted in expenditure of \$280 million being distributed between grants and loans in a ratio of 60:40. A Federal-Provincial Task Force on Student Assistance in Canada, reporting in 1981, projected this expenditure forward to 1981-2, assuming no changes in the system and also estimated the costs of different combinations of loans and grants. Their report concluded: "For a budget of a given size there was a direct relationship between the proportions of loans in the program and the number of students who could be assisted. Conversely, the same number of students could be aided at less cost to governments in programs that contain more loans than in programs that contain more grants." (Canada Task Force 1981, p.137).

The Task Force estimated that to continue to allocate the student aid budget in the ratio of 60% grants, 40% loans would cost Canadian \$400 million in 1981-2. To change to an all -grants program would cost an

additional \$290 million but to change to an all-loans program would save \$185 million. The full calculations of the cost of alternative combinations of loan and grant are shown below in Table 1.

TABLE 1

Estimated Costs of Alternative Combinations of Grants and Loans, Canada, 1981-82

| Program mix   | Estimated cost, 1981-82 \$ Canadian | Costs as a per cent of present mix |
|---|-------------------------------------|------------------------------------|
| 1979-80 mix of loans and grants                                     | 400,000,000                         | 100                                |
| 100% loans  | 215,000,000                         | 54                                 |
| 75% loans/25% grants  | 335,000,000                         | 84                                 |
| 50% loan/50% grants   | 455,000,000                         | 114                                |
| 25% loan/75% grants   | 575,000,000                         | 144                                |
| 100% grant  | 690,000,000                         | 173                                |
| First \$1000 of need is a loan and remainder is 75% loan, 25% grant | 330,000,000                         | 83                                 |
| First \$1000 of need is a loan and remainder is 50% loan, 50% grant | 445,000,000                         | 111                                |
| First \$1000 of need is a loan and remainder 25% loan, 75% grant    | 535,000,000                         | 134                                |
| First \$1000 is grant and remainder is 75% grant, 25% loan          | 575,000,000                         | 144                                |
| First \$1000 is a grant and remainder is 50% grant, 50% loan        | 465,000,000                         | 116                                |
| First \$1000 is a grant and remainder is 25% grant, 75% loan        | 375,000,000                         | 94                                 |

Source: Federal-Provincial Task Force Report, p.136.



ANNEX 2

The "Hidden Grant" in some Student Loans

If loans are offered to students at a very low rate of interest, or even interest-free, the real value of the loan repayments will be worth less than the amount borrowed, because of the difference between the subsidized (or zero) interest and market rates of interest.

If a bank offers students loans at 4%, but expects businessmen to pay 10%, then the bank is sacrificing 6% interest. If the student loan is repaid over a 10 year period, as in the USA, or even over 20 years as in Germany and Sweden, then the bank (or the government, in the case of a government financed program) will lose 6% interest each year and the value of expected student loan repayments in the future is considerably lower than the value of future repayments of a loan at a commercial rate of interest of 10%.

This loss to the bank or government is, of course, a gain to the student, who would otherwise have to pay 10% interest. The monetary effect is the same as if the student had been given a small grant, plus a loan at a full commercial rate of interest. A recent research study by Johnstone (1986) uses this type of calculation to estimate the gains to the student borrower and the losses to the government involved in the subsidized loan programs in the Federal Republic of Germany, Sweden and the USA. The student's gain is described as "effective" or "hidden" grant. This "hidden grant" is much less in the USA, where students with GSLP loans have to pay 8% interest and repay within 10 years than in Germany, where the loan is repaid over 20 years, and is free of interest. In fact if we assume a true rate of interest of 10%, the terms of the loans are equivalent to giving an American student a 25% grant and 75% loan, a Swedish student a 50% grant and 50% loan, and a German student a 78% and 22% loan.

ANNEX 3

Student Loan Agencies in Jamaica and Barbados

In Jamaica the Students' Loan Bureau was set up in 1970, with initial capital provided by the Bank of Jamaica, partly financed by a loan from the Inter-American Development Bank (IDB) and partly by counterpart funding from the government of Jamaica. Since it was established, the Students' Loan Bureau has awarded over 12,000 loans. The Student Revolving Loan Fund (SRLF) was set up in Barbados, in 1976, also financed through a loan from IDB. Both are specialised agencies, with responsibility for day-to-day administration of student loans on the basis of terms agreed with the government, which provides guarantees against default and also subsidises the interest on student loans.

The administrative structure of the SRLF in Barbados consists of:

a) The Management Committee, which includes representatives of;

- \* Ministry of Education
- \* Ministry of Finance and Planning
- \* University of the West Indies
- \* National Training Board
- \* Other educational and training institutions

Responsibilities of the Management Committee include:

- \* establishing terms and conditions of student loans and ensuring that correct financial procedures are followed

b) The Administrative Committee, which consists of a Secretary/Accountant, Clerical Officers and Secretarial staff.

Responsibilities of the Administrative Committee include:

- \* publicity,
- \* processing loan applications,

- \* determining eligibility in accordance with regulations laid down by the Management Committee,
- \* keeping up-to-date records of student loans, and keeping financial and other statistical data on the operation of the fund

c) The Financial Agent (the Barbados National Bank) which has responsibility for:

- \* drawing up contracts with loan repayments
- \* disbursement of loans
- \* collection of loan repayments
- \* refer all loans in arrears (more than 180 days) to the Management Committee
- \* carrying out internal audits

The conditions of the IDB loan require the SRLF to carry out regular evaluations of the loan program and to monitor effectiveness by collecting data on:

- \* number of loans awarded
- \* the family income level of borrowers
- \* their educational progress
- \* number of drop-outs and reasons
- \* number of graduates, by subject
- \* their subsequent employment

ANNEX 4

State Guarantee Agencies for Student Loans in the USA

Many states have set up their own agencies to administer and guarantee student loans. For example the State of Virginia has established the State Education Assistance Authority (SEAA), which aims to "make private capital available for low-cost long-term educational loans" and to ensure that they are administered as efficiently as possible. In 1985 the Agency guaranteed nearly 50,000 GSLP and PLUS loans, and was responsible for 293,000 loans outstanding. The agency monitors the banks providing the loans, tries to ensure that collection procedures are efficient and that defaults are kept to a minimum, but meets the cost of default claims if the borrower is unable to repay the loan. The cumulative default rate on all SEAA guaranteed loans over the last 25 years is 5.7%, which compares well with many other loan programs.

The steps involved in the processing of a loan application by the lending institution, the college or university and the SEAA is shown overleaf.

Determining Eligibility for Student Loans

In Hong Kong applicants for loans have to provide information on both earned and unearned income of all members of the household and all brothers and sisters, even if resident outside Hong Kong. This must be supported either by documentary evidence or by a signed certificate from employers, and all family and household members must sign a form which allows the Joint Committee on Student Finance (JCSF) to investigate the accuracy of their statements. Spot-checks are made on a random sample of applications, and these include visits to the home to verify details provided. Applicants who provide false information are liable to be prosecuted which reduces the temptation to cheat. Such a system is expensive to administer, but does ensure that loans are given only to students with genuine financial need.

In Canada, the terms of student loans vary between the provinces. In the province of Ontario, for example, applicants must satisfy various criteria including:

- \* Citizenship
- \* Residence
- \* Study in an approved institution
- \* Study on an approved course
- \* Satisfactory Scholarship standing
- \* Calculated financial need

The calculation of financial need takes account of the costs of different courses, and a student's "available resources", including parental income. The assessment process is illustrated overleaf:

ANNEX 6

Repayment of Student Loans

Student loans in Indonesia are available, on the basis of a strict means test, at 6% interest and must be repaid in 5 to 7 years. There is a grace period of 1 year, before graduates are required to begin repayment. After one year they are expected to repay their loan by means of regular monthly instalments. In the case of public sector employees (such as teachers or civil servants) loan repayments are deducted at source, by the employer, but other employees are expected to pay their monthly instalments at the local branch of the state-owned bank (BNI 1946) which administers the loan scheme. The maximum loan repayment is fixed at 30% of a graduate's gross monthly salary, but the majority of graduates pay considerably less than this. A typical monthly repayment is Rp 10-12,000, which is 10% of the starting salary of a graduate in the civil service.

In Japan, there are two types of loan: interest free loans for students at the upper secondary level, and for low-income students at the undergraduate and postgraduate level in universities, and loans at 3% for university students who do not qualify, on grounds of low income, for an interest free loan. Annual instalments depend on the size of the loan.

In Canada loans are interest-free during study, and during a "grace period" of six months. After this, the rate of interest that a borrower pays is fixed by the provincial student loan agency, in relation to market interest rates. This means that students who borrow when interest rates are high must pay more than those who borrowed when interest rates were low.

STUDENT LOAN SYSTEM: FINANCIAL MODEL

ANNEX 7

KEY FEATURES -

|                                       | 2      | 3      | 4      |
|---------------------------------------|--------|--------|--------|
| <u>ASSUMPTIONS (VARIABLES)</u>        |        |        |        |
| PERIOD OF LOAN (YRS)                  |        | X      | X      |
| PERIOD OF REPAYMENT (YRS)             |        |        |        |
| PERIOD OF GRACE ON INTEREST (YRS)     |        |        |        |
| PERIOD OF GRACE ON CAPITAL (YRS)      |        |        |        |
| INTEREST RATE (%)                     |        |        |        |
| AVERAGE ANNUAL LOAN SIZE YEAR 1 (£K)  |        |        |        |
| RATE OF INFLATION                     |        |        |        |
| DEFAULT RATE (% OF BORROWERS)         |        | X      | X      |
|                                       |        |        |        |
| <u>FINANCIAL FLOWS</u>                |        |        |        |
| TIME PERIODS →                        | YEAR 1 | YEAR 2 | YEAR 3 |
| NO. OF NEW ENTRANTS THIS YEAR:        |        |        |        |
| NO. OF DEFAULTERS                     |        |        |        |
| NO. RECEIVING LOANS                   |        |        |        |
| VALUE NEW LOANS THIS YEAR             |        |        |        |
| CUMULATIVE TOTAL LENT                 |        |        |        |
| CAPITAL REPAYMENTS THIS YEAR          |        |        |        |
| NET CAPITAL POSITION (CUMULATIVE)     |        |        |        |
| INTEREST PAYABLE THIS YEAR ON FUNDING |        |        |        |
| INTEREST PAID (CUMULATIVE)            |        |        |        |
| INTEREST RECEIVED THIS YEAR           |        |        |        |
| NET INTEREST POSITION (CUMULATIVE)    |        |        |        |
| NET CASH POSITION THIS YEAR           |        |        |        |
| NET CASH POSITION (CUMULATIVE)        |        |        |        |

ANNEX 8

What is a Reasonable or an Excessive Level of Debt?

This question has caused much controversy in the USA, where 4.3 million students borrowed over US\$ 9 billion in 1985. Costs vary enormously in the USA according to type of institution and level of course. In 1985/86 average costs ranged from \$3,000 to \$15,000 a year, which would mean \$12,000 to \$60,000 in total for a 4 year degree course. The borrowing limits of GSLP and PLUS loans are set as follows:

- \* students cannot borrow more than the total cost of education at their particular institution (defined as tuition fees plus "reasonable" living expenses, books, equipment and travel.)
- undergraduates cannot borrow more than \$2,500 a year and \$12,500 in total
- graduate students cannot borrow more than \$5,000 a year and \$25,000 in total.

A recent survey of students in California, by Hansen and Rhodes, (1986) showed that 59% of final-year undergraduates had incurred debts. The average debt was \$4,900, but 10% of students had debts of \$10,000 or more. In general, in the USA, graduates with the biggest debts - such as doctors and lawyers - can look forward to higher than average incomes. Based on an average graduate income of \$20,000 the borrowing limits set by the GSLP would mean that just over 9% of a graduate's income would have to be devoted to loan repayments, and recent research showed that approximately 90% of GSLP borrowers had to spend less than 10% of their gross income on loan repayments. Thus The results of the California survey suggest that if loan repayments of 10% are regarded as a "reasonable" level of debt, then only 9% of all GSLP borrowers have "excessive" debts.



ANNEX 9

How Much of a Graduate's Income is Required for Loan Repayments?

In Hong Kong the Director of Audit recently calculated that on the present terms a graduate repaying a student loan would need to allocate 6 to 7 per cent of monthly salary for 5 years to repay his or her loan at current salary scales. When average starting salaries of graduates were compared with those of non-graduates, it was found that loan repayments would represent between 20 and 27% of the earnings differential of university graduates and between 13 and 42% of the earnings differential enjoyed by diploma holders from the polytechnic (see Table).

On the basis of these figures, the Director of Audit recommended that Hong Kong students should receive all their financial assistance in the form of a loan, instead of a mixture of grant-plus-loan, as at present. Because the loans in Hong Kong are interest-free, even if all grants were converted to loans, the loan repayments would still represent only 8 to 10% of average starting salaries and 18 to 58% of differential earnings.

Table 3.8 Percentage of Earnings which would be  
Required as Repayments of Full Loans

| Institution<br>Graduating From | <u>% of Total Monthly Earnings</u> |                     | <u>% of Extra Monthly Earnings</u> |                     |
|--------------------------------|------------------------------------|---------------------|------------------------------------|---------------------|
|                                | Existing Loan<br>Repayments        | Total<br>Assistance | Existing Loan<br>Repayments        | Total<br>Assistance |
| Hong Kong Univ.                | 6%                                 | 8%                  | 20%                                | 30%                 |
| Chinese Univ.                  | 7%                                 | 10%                 | 27%                                | 37%                 |
| HK Polytechnic                 |                                    |                     |                                    |                     |
| Higher Diploma                 | 7%                                 | 9%                  | 42%                                | 58%                 |
| Diploma                        | 6%                                 | 8%                  | 13%                                | 18%                 |

Source: Director of Audit 1985, p.23.

ANNEX 10

Loan Collection in Sri Lanka

In Sri Lanka, two research studies on University Students Loan Scheme, carried out for the People's Bank (Hewagama 1978 and Hemachandra 1982) concluded that loan recovery procedures had not worked well, with the result that loan repayments represented only about 15% of the total value of loans awarded in Sri Lanka between 1964 and 1980. The main reasons for this were that:

- a) "Many students who obtained loans avoid repayment ever after they have obtained employment."
- b) "Inadequate attention [had been] paid by the Bank to recoveries of loans" (Hemachandra 1982, p. 4).

One reason for this lack of concern about loan repayments may be that the People's Bank, which administers the loan scheme in Sri Lanka is a state-owned bank, which does not have an obligation to make a profit, like a private commercial bank. Rather, its role, with respect to the student loan program, is to act as an agent for the government, and administer a government program financed entirely from public funds.

In fact, in Sri Lanka the student loan program has been partially replaced by a program of scholarships financed by a National Lottery (the Mahapola Higher Education Scholarship Trust Fund). At the same time, however, the government has attempted to improve enforcement of loan repayments and a new Higher Education Loan Act, passed in 1983, requires all employers to collect information from all their employees about outstanding loans, and to pass on this information to the Bank. All new employees are also required to give information about outstanding loans, and employers will be required to deduct loan repayments from their monthly salaries. The effectiveness of these measures will, of course, depend on whether the government of Sri Lanka is prepared to prosecute employers who do not comply with the Act.

Default Rates in the USA

Critics of loans sometimes point to high default rates in the USA, but a study of default rates in the USA (Hauptman 1983) concluded that: Taking account of the money that is eventually collected from borrowers who make late repayments, the "net" default rates for GSLP loans was between 3.8 and 5.8%. The default rate in other federally-insured programs, such as the Small Business Administration, appears to be no better and is sometimes worse than than for student loans. The GSLP made over 20 million loans worth \$35 billion between 1965 and 1982. The NDSLPL made 7 million loans worth \$8 billion. About \$10 billion of these loans were in repayment status in 1983 and "the vast majority (ie. over 90%) are being repaid on a prompt and regular basis."

Federal costs for default-related claims on GSL's have declined as a proportion of the total costs of GSLP. Costs associated with defaults amounted to less than 10% of total federal expenditure on the GSLP in 1981 and 1982.

Agencies have improved their loan servicing and collection procedures in recent years. State guarantee agencies have made significant strides in implementing procedures to prevent GSL defaults and to collect on defaulted loans. Hauptman finally concludes: Although loan defaults continue to require close attention, the problem is not as disastrous as critics have claimed.



LESOTHO

# The Loan Bursary Agreement

Loan Bursary Agreement entered into Between the Government of Lesotho (Hereinafter called the "Government")

and

(Hereinafter called the "Borrower")

WHEREAS the Borrower has requested the Government to assist in financing the entire training of the Borrower by granting a loan to him in the amount specified hereunder:

AND WHEREAS the course of training of the Borrower is justified from the standpoint of the priorities reflected in the national development plans of Lesotho.

AND WHEREAS the Government has agreed, on the basis, inter alia, of the foregoing, to grant a loan to the Borrower in the amount of \_\_\_\_\_

NOW THEREFORE, the two parties hereby do agree as follows:

1. The Borrower undertakes:—

- (a) to serve the country after the completion of his course of study for a minimum of 5 years;
- (b) where studies are undertaken abroad, to return to Lesotho immediately on completion of the authorised course of training or to pay 100% of the loan forthwith;
- (c) not to change his course of study without the written consent of the National Manpower Development Council on behalf of the Government. Any application to change the course of study shall only be considered by the said Council subject to a written recommendation of the Tutor or Head of Department of the institution concerned;
- (d) to attend, during the course of his training, all lectures, tutorials, field work, practical work and all other training required for his course and to successfully complete each study year. A student will be excused from this condition only on production of medical certificate stating that the disease was the cause of failure;
- (e) not to commit a criminal offence;

- (f) not to use habit-forming drugs whatsoever;
- (g) not to be found drunk.

2. The Government undertakes:—

- (a) to pay the travelling expenses of the Borrower to and from the location of training if such training is undertaken outside Lesotho;
- (b) to pay the living allowance and residential expenses of the Borrower, provided such costs do not exceed the normal student rate applicable to the specific educational institution;
- (c) to pay tuition, book allowance and any other allowances required for the course of training as spelt out in the official prospectus of the particular institution.

3. The parties further agree that the Government may at any time terminate the Borrower's course of training, withdraw his loan, and require him to repay all the monies that had already been expended on his training, if the Government is satisfied that the Borrower has contravened any of the provision of Clause 1, or if the Borrower requests that the course of training be terminated.

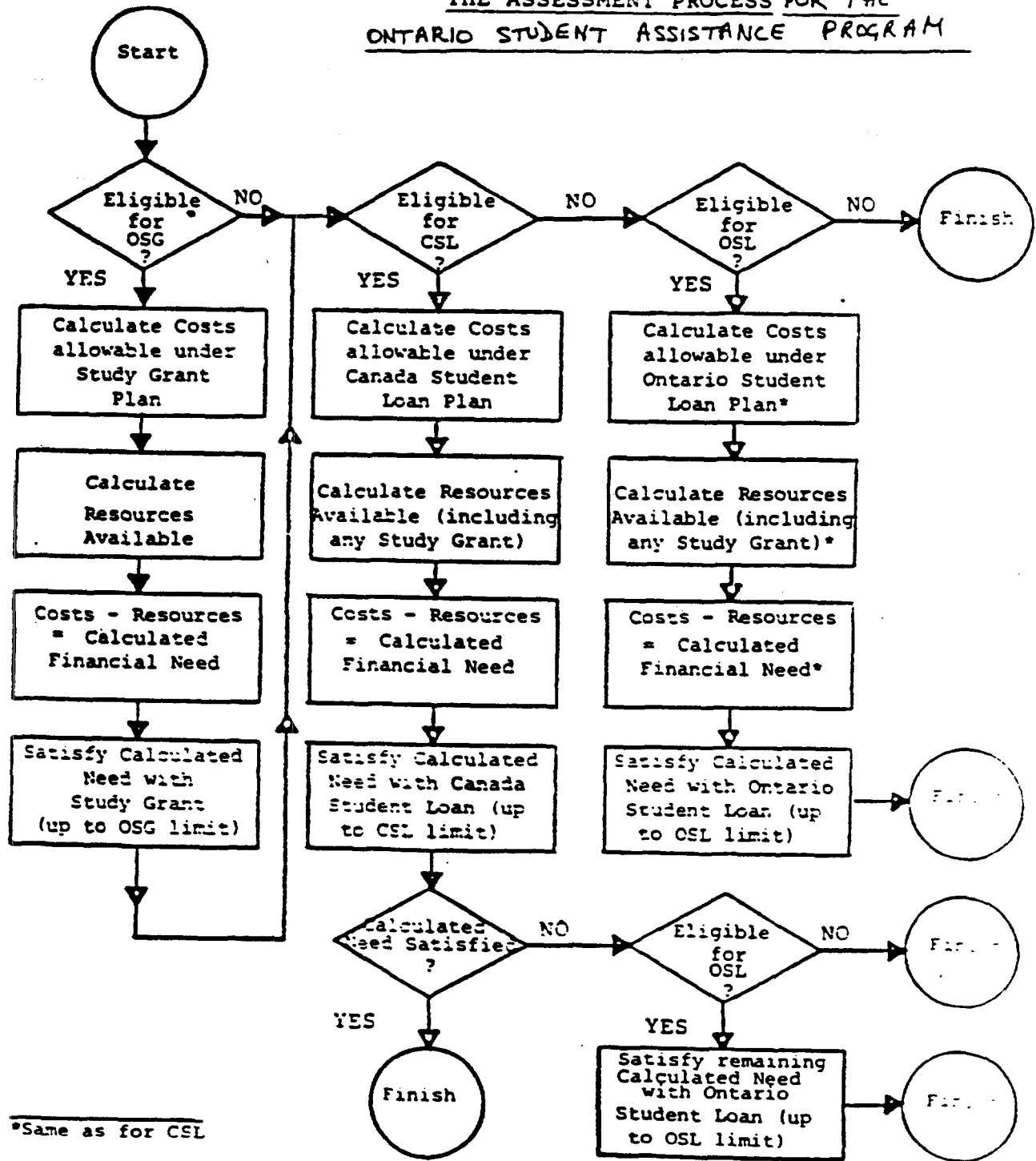
4. In the payment of the loan, the Borrower undertakes to repay

- (i) 100% of the loan if he decides not to work within Lesotho after the completion of the course of training;
- (ii) 65% of the loan if he decides to work in the private sector or for a para-statal organisation of which the Government has no controlling interest;
- (iii) 50% of the loan if he works in the Public Service or in Government — controlled para-statal organisation.
- (iv) For purposes of repayment of the loan by students training overseas, the loan fund to be repaid will be considered equal to the equivalent fees payable in Lesotho.
- (v) For students with a record of outstanding performance a 10% credit will be given i.e. for students in the public service or Government controlled para-statals and students in the private sector to pay 40% and 55% of the loan respectively.

5. The Borrower hereby consents to the jurisdiction of the court of the Resident Magistrate of Maseru for the purpose of any legal action instituted against him upon or arising out of this Agreement not withstanding the fact by virtue of the amount of relief claimed the said action would otherwise not be within the said Court, the Borrower

chooses domicilium citandi at \_\_\_\_\_ (This address must be within Lesotho)

THE ASSESSMENT PROCESS FOR THE  
ONTARIO STUDENT ASSISTANCE PROGRAM



\*Same as for CSL

Key: OSQ Ontario Study Grant  
CSL Canada Student Loan

# OPERATIONS AND PROCESSING

The borrower's completion of an application for the GSL or PLUS loan is the first of several steps. The borrower initially obtains an application from a participating lender. The format of the application guides the borrower through the necessary steps for approval by the school, the lender and the SEAA. In summary, these steps are as follows:

OF LOANS BY THE STATE  
EDUCATION ASSISTANCE AGENCY (SEAA)  
OF THE STATE OF  
VIRGINIA, USA

