Reforming Student Financial Aid: Issues and Alternatives

Arthur Hauptman

July 2002

The World Bank
Latin America and the Caribbean Regional Office
Reforming Student Financial Aid: Issues and Alternatives

Arthur Hauptman

July, 2002

Papers prepared in this series are not formal publications of the World Bank. They present preliminary and unpolished results of country analysis or research that is circulated to encourage discussion and comment; any citation and use of this paper should account of its provisional character. The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors and should not be attributed in any manner to the World Bank, its affiliated organization members of its Board of Executive Directors or the countries they represent.
Preface

The Government of Colombia is examining options for improving the higher education sector over the next decade. As part of that process, the World Bank, at the behest of the Government, undertook an assessment of the state of tertiary education and made recommendations on how its funding, governance, structure, and scope could be reformed to better meet the needs of the country and the challenges it will face in a global market economy. The Bank’s analysis will become available in a sector study later in 2002.

Five background studies focussed on issues identified as important for the growth and development of tertiary education in Colombia. The purpose was to move towards operationalizing the substantial knowledge base which has been created about Colombian tertiary education over the last decade. The paper, Colombian Tertiary Education in the Context of Reform in Latin America, by José-Joaquin Brunner, analyzes the underlying causes behind the underdevelopment of Colombia’s higher education system, the challenges it is currently facing and the transformations and policies that could be implemented to forge the necessary changes. The concern about quality in tertiary education and the mechanisms in place to ensure quality in Colombia are discussed in the fourth paper Quality Assurance in Colombia, by Robin DePietro-Jurand and Maria-José Lemaitre. The challenges for Colombia’s national innovation system could not be underestimated. In Science and Technology: Status and Perspectives, Natalia Agapitova, Lauritz B. Holm-Nielsen and Goga Vukmirovic demonstrate that while all of the essential elements of an innovation system are present in the country, due to a lack of finance, a poor scientific base, and limited labor competencies, the national innovation system is substantially underdeveloped and incoherent. The marketplace for knowledge is global. How does Colombia fare in this market? Over the last decade, foreign institutions have begun to play an ever expanding role in the Colombian market for higher education, migration of Colombian graduates (brain drain) is on the rise, and globalization in general posing a challenge to Colombian higher education. These issues are discussed in the paper Colombian Higher Education in the Global Market, by Isabel Cristina Jaramillo, Patricia Garcia and Andreas Blom. The economic opportunities are dealt with in Economic Perspectives of Higher Education by Andreas Blom and Thomas Hansen who investigate two central markets surrounding higher education in Colombia: the market for higher education itself and the labor market for workers with higher education. Finally, the seventh paper by Arthur Hauptman, Reforming Student Financial Aid in Colombia: Issues and Alternatives examines the student aid structure in Colombia and recommends principles to guide its reform.

We have decided to make these studies available as LCSHD discussion papers in order to stimulate thought and debate, which eventually will encourage improvement of Colombia’s tertiary education system.

Lauritz B. Holm-Nielsen
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>What is the Existing Aid Structure in Colombia?</td>
<td>4</td>
</tr>
<tr>
<td>What are the Strengths and Weaknesses of the Current Student Aid Structure?</td>
<td>10</td>
</tr>
<tr>
<td>Problems and Challenges to Colombian Higher Education Addressed by the Proposed Reforms in Student Financial Aid</td>
<td>13</td>
</tr>
<tr>
<td>The Appropriate Mix Between Student Financial Aid and Direct Support of Institutions?</td>
<td>14</td>
</tr>
<tr>
<td>The Appropriate Mix Between Scholarships and Credit?</td>
<td>15</td>
</tr>
<tr>
<td>Need-based Discounts and Scholarships Versus a Voucher-System?</td>
<td>17</td>
</tr>
<tr>
<td>Built Entirely New Credit Structure or Develop Existing Structure?</td>
<td>18</td>
</tr>
<tr>
<td>LCHSD Paper Series</td>
<td>23</td>
</tr>
</tbody>
</table>
Introduction

Colombian policymakers have decided that the expansion and reform of the existing student aid programs, particularly student credit, should represent a primary vehicle for addressing challenges to the Colombian higher education sector. Thus, a principal objective is to consider how reforms in the student aid programs – scholarships as well as student credit -- can help to address pressing problems in the higher education sector. To this end, this annex poses a series of related questions that government policy makers, institutional officials, and other stakeholders in Colombia ought to consider in designing student aid reforms. These questions include:

- What is the existing aid structure in Colombia?
- What are the strengths and weaknesses of the existing aid system?
- What are the problems and challenges to Colombian higher education that the proposed reforms in student financial aid should attempt to address?
- Under a revised financing structure, what should be the mix between student aid and direct support of institutions?
- Under a revised student aid structure, what should be the mix between scholarships and credit?
- Should scholarships continue to be provided through need-based tuition and discounts or should the government restructure the system to operate more like a voucher?
- Should the new student credit structure be built on existing efforts or should an entirely new system be constructed?

Summary of Suggested Changes

In the process of addressing the questions listed above, this annex comes to a series of conclusions regarding the future size and scope of student financial aid in Colombia. These conclusions include the following principles for reform and specific features:

Principles for Reform of the Student Aid Structure in Colombia. To ensure a more effective and more equitable student aid structure in Colombia, the analysis in this annex suggests that the following principles should govern any reform effort:

The reformed student aid structure should be utilized to improve the quality and relevance of the higher education sector as well as increase access. In most countries, student aid programs are created to provide greater access with relatively little concern for their impact on quality and relevance. In Colombia, a reformed student aid structure should seek to improve quality and relevance as well as expanding access. One way to use student aid reforms to improve quality would be to require that student aid recipients attend a program that is judged to be of adequate quality as measured by its ranking in an accreditation process in which programs, not institutions, are the primary focus of the investigation. To use student aid to improve relevance, aid recipients might be required
to enroll in programs judged to be of high national priority to receive government-funded scholarships or to borrow under the expanded student credit program.

**The share of government funding devoted to student aid should be increased and any reform effort should include an expansion of both scholarships and credit.** The existing student aid effort in Colombia is small relative to the overall level of government support for higher education – less than one percent is devoted to aid – and the support is slanted toward credit, with more than 95 percent of all government-funded aid being in the form of loans. A key element of any reform strategy should be to increase funding for student aid for both scholarship and credit activities. This additional support for student financial aid might be funded through a reallocation of funds otherwise provided directly to institutions or through additional government funding of higher education. It is not recommended that World Bank loan funds be used to finance this increase in scholarships in the long term, although some start up funding in the short-term might be appropriate.

**Scholarships** (scholarships) **should be the key policy for meeting the needs of qualified students from the lowest income families.** To the extent that student credit programs are typically more tailored to meet the needs of middle class students, it will be important that a substantial portion of any increase in student aid funding be used to augment scholarships. To ensure that this scholarship assistance is targeted on poor but deserving students, these scholarships should be awarded on the basis of both financial need and academic merit. Under such an aid structure, students with the high need and high merit would be eligible for scholarships while students with some need and/or merit would be eligible to borrow. This arrangement between scholarships and credit is illustrated in Chart 1.

**The existing student credit system that relies on ICETEX and banks should be built upon to expand the availability of student credit rather than create a new structure.** In most countries, student loan default rates are unacceptably high and any reform of the student credit system therefore must include a radical restructuring or possibly a completely new program. This is not the case in Colombia since it has one of the oldest student credit programs in the world with respectable rates of repayment. These strengths suggest that the existing structure should be modified rather than scrapped. The weaknesses of existing structure that need to be addressed include a lack of liquidity and a lack of coverage, with less than 10 percent of all students borrowing in recent years.

To increase coverage, it will be necessary to utilize the private sector as a source of capital since it is unrealistic to expect the government to provide the necessary funding. Expanding coverage of credit to, say, 20 percent of all students – roughly doubling current coverage rates – would require more in loan capital that it is realistic to expect the government to provide in the current environment. Thus, private banks, which already have demonstrated a capacity to innovate in meeting demand for student credit in Colombia, must play a central role in the new loan structure by providing the initial
capital for many new loans. To ensure that the banks have an incentive to maintain a
good repayment record, they should share in the risk of loss. In addition, ICETEX must
continue to be a source of credit for students who do not qualify for bank-based loans.

A key reform needed in Colombia is to establish a secondary market (second floor bank)
to increase liquidity of the student credit system. Several existing organizations might be
assigned this responsibility, including ICETEX, or a new one could be created. A critical
aspect of implementation of student aid reforms in Colombia will be to determine
whether ICETEX as an organization is capable of accepting this responsibility. Based on
ICETEX’s response to data requests in the development of this annex, there are real
questions regarding its capacity to administer a second floor bank.

Whatever group or organization is assigned the responsibility for serving as a secondary
market, private investors such as pension funds and individuals must be relied as a source
of financing and should be assured a competitive return on investment. A description of
how such a system might work in Colombia is provided below. In terms of the roles of
various organizations already involved in providing aid, the following is contemplated:

- The role of the government under the reforms proposed in this annex would be
two-fold: 1) to establish through legislation and to provide start up funding for a
student credit secondary market (second floor bank) to provide greater liquidity
and 2) to provide a guarantee fee to ICETEX for new loans that it makes directly
to students. It is recommended that this fee should be paid upfront as a
percentage of loans guaranteed rather than as an open-ended commitment that
would guarantee lenders or note holders a portion of losses on all loans made.

- The role of ICETEX would be: 1) to continue making and servicing loans to
students who do not meet credit worthiness standards in the bank-based program,
and 2) to possibly become a secondary market for both bank loans as well as
those made by ICETEX. If ICETEX were to become a secondary market, its role
as a public entity would become more blurred because it would now be using
private investor funds to finance its second floor banking activities.

- The role of commercial banks in providing student credit would continue largely
as it is now - to lend to credit worthy student borrowers and to service those
loans. Bank-based loans, though, would expand beyond the traditional role of
providing of short-term credit because the creation of a secondary market would
allow for longer terms.

- The role of Fondo Guarantia in student crediting would also remain largely as it
now is – to guarantee a portion of the loans made by the private banks with which
it has agreements, although its mix of student credit would shift to longer term
instruments.

- The role of HE institutions would be to accept less than the face value of the loan
as payment for an equivalent amount of tuition fees. This would be key for
allowing student borrowers to be charged an interest rate below market
conditions. The government should also take steps to encourage HE institutions
to provide more non-repayable aid to their students through need-based tuition or discounts.

What is the Existing Aid Structure in Colombia?

Student financial aid is currently made available to Colombian students through: government-funded scholarships (scholarships); discounts from tuition and fees offered by public and private institutions of higher education; and student loans (credit).

Government-Funded Scholarships. The national and state governments provide very little in the way of scholarships through a formal funding process. At the national level, funding for scholarships amounted to less than 1 percent of total government funding for higher education, providing scholarships for an estimated 25,000 or less recipients in 2000.

The government-funded scholarships are administered on a decentralized basis through agencies such as ICETEX, COLCIENCIAS, and COLFUTURO. In each case, the government funds the agency that in turn administers the programs according to government rules. The scholarship programs administered by ICETEX are listed in Table 2 and range from scholarships for study abroad to a series of programs that fund scholarships for specific groups of students. COLFUTURO funds only graduate students who study abroad while COLCIENCIAS funds assistantships for research-related activities.

Discounts Provided by Institutions. A more substantial amount of financial aid is provided through the discounts that both public and private HE institutions in Colombia provide to their students. At public institutions, these discounts are provided mostly through the need-based tuition and fee system in which students are charged on the basis of his or her family financial circumstances. Under this need-based tuition system, family income, family size, area of residence and other factors are used to calculate need or ability to pay. This use of need-based tuition distinguishes Colombia from most other countries where tuition levels are the same regardless of student circumstances and financial aid is used to help students from lesser circumstances. There appears to be no reliable data on how much aid is provided through need-based tuition, however.

At private institutions, scholarships now are more typically in the traditional form of discounts from the stated tuition and fees. In the past, many private institutions engaged in charging need-based tuition, but most in recent years have switched to a fixed tuition in part because of mounting concerns that many students were ‘gaming’ the system by understating their family resources. Now only a few private institutions have need-based tuition systems like those in place at most public institutions. As in the case of public institutions, there are no systematic data on how much aid is provided through discounts by private institutions. But we do know that roughly 500 thousand students are enrolled in private institutions and that tuition levels range from a low of US $300 to a high of
US$ 2000. If the average level of tuition is US$ 1000, then total tuition revenues would be roughly US$ 500 million. If 20 percent of students receive a partial discount of half tuition, that would mean the total level of tuition discounting amounted to an estimated $US 100 million in 2000. This figure would undoubtedly dwarf the funds formally allocated through the government to student aid through the government.

**Student Credit.** There are two types of credit programs available to students attending Colombian institutions of higher education. In addition, another credit program is available to students studying at institutions abroad.

1) Colombian Institute for Education Credit and Advanced Studies Abroad (ICETEX)

ICETEX is generally acknowledged as the oldest government sponsored student loan program in the world. It was established in 1950 and began operations in 1952 so it legitimately is celebrating its silver anniversary. It is often viewed as a model for other countries to emulate in making credit available to their students. Initially, ICETEX was formed to provide loans to students studying abroad. But in 1968, eligibility for loans from ICETEX was expanded to include students enrolled in Colombian HE institutions. As Table 2 shows, the changes made in 1968 led to a substantial expansion in ICETEX activities over the following three decades. In addition, an increasing share of ICETEX activities has been for borrowers engaged in domestic studies; in the 1990s, more than 95 percent of its lending was to students enrolled in domestic institutions.
Table 1: 50 Year Trends in Number of Beneficiaries under ICETEX

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Country Loans</strong></td>
<td>748</td>
<td>15,781</td>
<td>123,493</td>
<td>250,081</td>
<td>465,719</td>
<td>855,822</td>
</tr>
<tr>
<td>Undergraduate</td>
<td>748</td>
<td>15,781</td>
<td>119,164</td>
<td>231,713</td>
<td>372,147</td>
<td>739,553</td>
</tr>
<tr>
<td>Postgraduate</td>
<td>-</td>
<td>-</td>
<td>4,329</td>
<td>18,368</td>
<td>52,136</td>
<td>74,833</td>
</tr>
<tr>
<td>Loans from TAE resources</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>41,436</td>
<td>41,436</td>
</tr>
<tr>
<td><strong>Foreign Loans</strong></td>
<td>681</td>
<td>3,981</td>
<td>3,523</td>
<td>5,931</td>
<td>7,529</td>
<td>21,645</td>
</tr>
<tr>
<td>Undergraduate</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>414</td>
<td>414</td>
</tr>
<tr>
<td>Postgraduate</td>
<td>681</td>
<td>3,981</td>
<td>3,336</td>
<td>4,864</td>
<td>5,979</td>
<td>18,841</td>
</tr>
<tr>
<td>Language Training</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>635</td>
<td>635</td>
</tr>
<tr>
<td>Scholarship-Loan</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>347</td>
<td>128</td>
<td>475</td>
</tr>
<tr>
<td>Student transportation</td>
<td>-</td>
<td>-</td>
<td>187</td>
<td>720</td>
<td>373</td>
<td>1,280</td>
</tr>
<tr>
<td><strong>Domestic Scholarships</strong></td>
<td>-</td>
<td>-</td>
<td>231,505</td>
<td>130,720</td>
<td>244,706</td>
<td>606,931</td>
</tr>
<tr>
<td>Primary Rural education</td>
<td>-</td>
<td>-</td>
<td>28,197</td>
<td>44,799</td>
<td>-</td>
<td>72,996</td>
</tr>
<tr>
<td>Secondary Rural education</td>
<td>-</td>
<td>-</td>
<td>186,027</td>
<td>85,921</td>
<td>244,706</td>
<td>516,654</td>
</tr>
<tr>
<td>and PACES*</td>
<td>-</td>
<td>-</td>
<td>17,281</td>
<td>-</td>
<td>-</td>
<td>17,281</td>
</tr>
<tr>
<td>Teacher's training</td>
<td>-</td>
<td>-</td>
<td>17,281</td>
<td>-</td>
<td>-</td>
<td>17,281</td>
</tr>
<tr>
<td><strong>Foreign Scholarships</strong></td>
<td>44</td>
<td>1,084</td>
<td>6,744</td>
<td>7,971</td>
<td>11,540</td>
<td>27,383</td>
</tr>
<tr>
<td>International cooperation</td>
<td>34</td>
<td>812</td>
<td>6,141</td>
<td>6,693</td>
<td>6,903</td>
<td>20,583</td>
</tr>
<tr>
<td>scholarships</td>
<td>-</td>
<td>42</td>
<td>107</td>
<td>507</td>
<td>32</td>
<td>688</td>
</tr>
<tr>
<td>Arts</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Miguel Antonio Caro project</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,198</td>
<td>1,198</td>
</tr>
<tr>
<td>stays</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,198</td>
<td>1,198</td>
</tr>
<tr>
<td>Inter-campus</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,297</td>
<td>3,297</td>
</tr>
<tr>
<td>Foreigners in Colombia</td>
<td>10</td>
<td>230</td>
<td>496</td>
<td>771</td>
<td>3,227</td>
<td>4,734</td>
</tr>
<tr>
<td>Other initiatives</td>
<td>1,099</td>
<td>19,665</td>
<td>53,287</td>
<td>1,331,243</td>
<td>620,019</td>
<td>2,025,313</td>
</tr>
<tr>
<td>Technical training assistance (law 100)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10,240</td>
<td>10,240</td>
<td></td>
</tr>
<tr>
<td>Black communities (law 72/)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5,855</td>
<td>5,855</td>
</tr>
<tr>
<td>Indigenous communities</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,297</td>
<td>3,297</td>
</tr>
<tr>
<td>assistance</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>286</td>
<td>286</td>
</tr>
<tr>
<td>Carolina Oramas assistance to Colombian artists</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12,897</td>
<td>12,897</td>
<td></td>
</tr>
<tr>
<td>Solidarity Network</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12,897</td>
<td>12,897</td>
</tr>
<tr>
<td>Funds under management **</td>
<td>624</td>
<td>3,435</td>
<td>31,820</td>
<td>58,287</td>
<td>184,099</td>
<td>278,265</td>
</tr>
<tr>
<td>MEN Program - parents</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>21,295</td>
<td>21,295</td>
</tr>
<tr>
<td>Regional Development</td>
<td>-</td>
<td>-</td>
<td>6,119</td>
<td>1,263,360</td>
<td>190,399</td>
<td>1,459,878</td>
</tr>
<tr>
<td>(APORTES)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>191,651</td>
<td>233,300</td>
</tr>
<tr>
<td>Authorization of funds to go abroad</td>
<td>475</td>
<td>16,230</td>
<td>15,348</td>
<td>9,596</td>
<td>191,651</td>
<td>233,300</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,572</td>
<td>40,511</td>
<td>418,552</td>
<td>1,725,946</td>
<td>1,349,513</td>
<td>3,537,094</td>
</tr>
</tbody>
</table>

Source: ICETEX
Type of Credit. Students borrowing through ICETEX may participate in a number of different types of credit programs. For students studying in Colombia, three types of credit are available:

Long Term. The most popular of ICETEX programs, for long term credit students repay the entire loan amount upon completion of their studies [interest in school as well?]. Undergraduates may borrow up to 70% of tuition at private universities and up to 100% of tuition at public universities. Graduate students may borrow up to 80% of tuition.

Medium Term. Borrowers may also borrow medium term credit by repaying half of what they owe while still in school with the remainder financed upon completion of studies. Students may borrow medium term up to 90% of their undergraduate tuition and 80% of their graduate tuition.

Short-term. Undergraduate and graduate students may borrow short-term up to 100% of their tuition, repaying it fully during the year in which they borrow in six monthly payments.

Credit is also available through ICETEX to support study abroad, including:

Graduate Studies. Students enrolling in graduate studies abroad may borrow up to US$8000 for a maximum of two years with repayment commencing within three months after studies are completed and fully payable within 5 years.

Language Courses. Students enrolling in language courses abroad can also finance through loans of up to $4000 payable within 30 months after studies are completed.

Student travel. Students may also borrow short term up to 100% of their international travel costs to be repaid one month after traveling.

Interest rates. Under each of these ICETEX programs, interest rates are set by the Directive Committee but cannot exceed limits established by law. The ICETEX interest rates from 1991 to 2001 in comparison to other rates and inflation are shown below.
Table 2: ICETEX Interest Rates and Other Indices, 1991-2001

<table>
<thead>
<tr>
<th>Year</th>
<th>ICETEX interest rate (%)</th>
<th>Inflation (CPI)</th>
<th>Real interest rate (%)</th>
<th>Commercial bank rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>24</td>
<td>26.8</td>
<td>-2.8</td>
<td>46.1</td>
</tr>
<tr>
<td>1992</td>
<td>24</td>
<td>25.1</td>
<td>-1.1</td>
<td>34.8</td>
</tr>
<tr>
<td>1993</td>
<td>24</td>
<td>22.6</td>
<td>1.4</td>
<td>36.4</td>
</tr>
<tr>
<td>1994</td>
<td>24</td>
<td>22.6</td>
<td>1.4</td>
<td>39.9</td>
</tr>
<tr>
<td>1995</td>
<td>24</td>
<td>19.5</td>
<td>4.5</td>
<td>43.2</td>
</tr>
<tr>
<td>1996</td>
<td>24</td>
<td>21.6</td>
<td>2.4</td>
<td>43.2</td>
</tr>
<tr>
<td>1997</td>
<td>24</td>
<td>17.7</td>
<td>6.3</td>
<td>33.8</td>
</tr>
<tr>
<td>1998</td>
<td>24</td>
<td>16.7</td>
<td>7.3</td>
<td>50.5</td>
</tr>
<tr>
<td>1999</td>
<td>22</td>
<td>9.2</td>
<td>12.8</td>
<td>27.3</td>
</tr>
<tr>
<td>2000</td>
<td>22</td>
<td>8.8</td>
<td>13.2</td>
<td>23.9</td>
</tr>
<tr>
<td>2001</td>
<td>22</td>
<td>7.7</td>
<td>14.3</td>
<td>31.0</td>
</tr>
</tbody>
</table>

Source: ICETEX  
Note: Commercial rate is from June each year.

Administrative Structure. In the ICETEX programs, students apply to one of the 21 regional offices of ICETEX, usually the one nearest their residence. Students are selected on the basis of their financial need as calculated by ICETEX, their academic performance, and the type of institution attended. Institutional criteria are critical in some cases and in every case, students must be enrolled in programs of study registered with ICHFIS. But ICETEX makes no differentiation in lending priority on the basis of the potential borrower’s field of study. When demand for credit exceeds supply of credit, priority is given in order of: 1) academic performance, 2) financial need, and 3) whether students are enrolled in public institutions. In terms of who receives the proceeds of the loan, students and their families receive the first disbursement to help them pay the initial tuition charge while all subsequent payments are made directly to the institution.

Sources of Funds. ICETEX relies on four principal sources of funds to finance the loans and scholarships they provide to students. These sources are:

Private and government third party trusts. In recent years, the growing source of funds for ICETEX loans has been trust funds deposited by private sector organizations or government agencies for the purpose of making loans to the children of their employees.

ICETEX’s own resources. Another important source of revenue to ICETEX are the repayments on outstanding loans, interest on investments and trust funds, and commissions.

Family Savings Plans. In recent years, a small but growing portion of revenues are the funds that families deposit with ICETEX that can serve as collateral for loans these families borrow to help pay for their children’s education.
Government transfers. In recent years, the government has not transferred funds to ICETEX for the purpose of making new loans. This is the principal reason for the decline in loan coverage over the past decade from roughly 12 percent to 6 percent.

ICETEX sources of funds in the year 2000 are indicated on Table 3 below.

<table>
<thead>
<tr>
<th>Total Funds in 2000</th>
<th>88,787,351,447</th>
<th>100.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third Party Trust Funds</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Government Agencies</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Private Organizations</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>ICETEX Own Resources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Repayments</td>
<td>67,309,098,406</td>
<td>75.8%</td>
</tr>
<tr>
<td>Investment Income</td>
<td>3,485,368,873</td>
<td>3.9%</td>
</tr>
<tr>
<td>Commissions</td>
<td>4,379,051,307</td>
<td>4.9%</td>
</tr>
<tr>
<td>Government Transfers</td>
<td>6,676,754,280</td>
<td>7.5%</td>
</tr>
<tr>
<td>Other income</td>
<td>405,678,581</td>
<td>0.5%</td>
</tr>
<tr>
<td>Financial Surplus</td>
<td>6,531,400,000</td>
<td>7.4%</td>
</tr>
<tr>
<td>Gain on exchange rate</td>
<td>319,136,507</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

Source: ICETEX

**Bank-based Student Credit**

Financing of student credit through the private banking system has become more commonplace in recent years, in part to meet the growing unmet demand for credit created by the declining coverage of ICETEX. Under this credit approach, Colombian banks have formed partnerships with individual HE institutions to provide short-term credit for students at those institutions. One bank has formed arrangements with as many as 30 institutions, another makes loans to students enrolled at a dozen institutions. For the most part, these loans have been in the form of short-term credit that must be fully repaid before the borrower completes his or her studies.

In the past several years, Fondo Nacional de Garantías (FNG), a government-sponsored guarantor of commercial loans, has guaranteed the loans at two banks offering student credit as a way to allow banks to make longer term student loans. ICETEX provided a substantial share of initial funding of this venture in an effort to expand longer term credit coverage to middle income students who do not qualify under the need restrictions of ICETEX lending. FNG guarantees the outstanding balance of capital and unpaid interest on loans made to students from families in the upper two income quintiles. It provides 60 percent guarantees for loans with repayments of less than 3 years and 70 percent guarantees for loans with repayment terms exceeding five years. In 2000, FNG
guaranteed roughly US$500 thousand in more than 600 loans. In 2001, it will guarantee roughly 2500 loans with a face value of US$2 million.

These bank-based efforts have exhibited a healthy degree of innovation and merit serious consideration as part of any reform effort. But coverage through bank-based student credit is also low and generally has been limited to more credit-worthy middle income students. In addition, bank-based credit has been largely limited to short-term borrowing because of the absence of a secondary market (second floor banking) in Colombia that would increase the liquidity of this lending.

COLFUTURO

In the early 1990s, COLFUTURO was established to provide loans and scholarships for graduate students studying abroad, in part taking up the slack created by the shift over time in ICETEX supporting domestic rather than foreign studies. Roughly half of the support provided is in the form of scholarships/fellowships and the other half is credit. In 2000, about 140 students were aided through COLFUTURO.

What are the Strengths and Weaknesses of the Current Student Aid Structure?

One of the most striking aspects of the current debate in Colombia over the condition of the higher education sector is the degree of consensus among key policy makers and institutional officials about the need to expand the student credit system to address pressing concerns to the HE system. It is rare in most countries to find such a degree of consensus around any particular policy issue or reform. Therefore, a natural place to start a discussion of the possible need for reform in the student aid structure in Colombia is to assess the strengths and weaknesses of the current set of aid programs. Our assessment is that the current aid structure has several very important strengths that should influence the design on any new structure. These strengths include:

- **High Repayment Rates.** Both ICETEX and the bank-based system have repayment rates of 80 percent or more. This is one of the better student loan repayment records in the world. The United States now has a student loan repayment rate of roughly 90 percent but as recently as a decade ago the default rate was roughly twice as high as it is now. The reduction in defaults in the U.S. was a function particularly of two events or trends. First, the economy in the 1990s did very well and as a result borrowers found themselves more able to repay their growing debt burdens. More importantly, however, the federal government took a number of steps to reduce or eliminate student aid eligibility for students attending institutions with a record of high default rates, a step it had not been willing to take before. As a result, a number of the affected schools were forced to close down and their contribution to any student loan default problem was reduced or eliminated.
In the case of Colombia, it appears defaults have been relatively low and the repayment rates have stayed high because of several factors. First, ICETEX lends only to students enrolled in programs approved by ICHLIS so that student credit is not extended to students enrolling in programs of questionable quality. International experience suggests that this is perhaps the most important factor in keeping default rates low. Second, especially in the bank-based program, loans are made only to credit worthy students primarily from middle class families.

Table 4: Default Experience of ICETEX, 1996-2001

<table>
<thead>
<tr>
<th>Year</th>
<th>Portfolio</th>
<th>Due</th>
<th>Due/portfolio</th>
<th>Un-recovered</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>132,004,742</td>
<td>36,623,307</td>
<td>27.7%</td>
<td>4,962,008</td>
<td>13.55%</td>
</tr>
<tr>
<td>1997</td>
<td>191,140,271</td>
<td>56,216,869</td>
<td>29.4%</td>
<td>7,545,161</td>
<td>13.42%</td>
</tr>
<tr>
<td>1998</td>
<td>249,665,264</td>
<td>81,834,685</td>
<td>32.8%</td>
<td>10,466,759</td>
<td>12.79%</td>
</tr>
<tr>
<td>1999</td>
<td>303,853,256</td>
<td>123,032,339</td>
<td>40.5%</td>
<td>16,062,784</td>
<td>13.06%</td>
</tr>
<tr>
<td>2000</td>
<td>364,454,727</td>
<td>151,845,785</td>
<td>41.7%</td>
<td>24,246,257</td>
<td>15.97%</td>
</tr>
<tr>
<td>2001</td>
<td>438,349,710</td>
<td>194,842,776</td>
<td>44.4%</td>
<td>34,132,036</td>
<td>17.52%</td>
</tr>
</tbody>
</table>

Source: ICETEX
Note: All in thousand pesos

Decentralized Administrative Structure. ICETEX through its 21 regional offices and the national banks through their network of local offices make loans throughout the country and require little in the way of administrative support from the government or the private sector. Many years of experience with a decentralized system make a big difference in the capacity of ICETEX to provide personalized service to students.

Long Term Commitment to Student Credit. In many countries around the world, there is strong opposition to the use of student credit from students and other groups in society. This typical stakeholder resistance to the establishment of high fees and the widespread use of student credit to pay for these high charges represents a major obstacle both to the expansion of higher education and narrowing the inevitable gaps in educational opportunity between rich and poor students as resources are constrained and higher education remains the domain of elite parts of society. In contrast, the concept of student credit has enjoyed strong support in Colombia. More than 800 thousand loans have been made over the fifty years that ICETEX has been in existence, with more than half of these loans being made in the 1990s alone.

But the existing student aid structure in Colombia also has a number of weaknesses, including:

Low Aid Coverage. The coverage of ICETEX has declined over time so that by the 1990s less than 10 percent of students borrowed each year. For example, an average of 50,000 students borrowed each year in the 1990s compared to enrollment
levels of roughly 800,000 students. This represents a reduction in coverage from the 1980s when between 10 to 15 percent of students borrowed. In addition, the current aid structure is inadequate to accommodate the large-scale expansion in student enrollments that is being contemplated as part of this project.

Scholarships also have a low rate of coverage, as less than one percent of all students receive government-funded scholarships every year. A higher proportion of students receive scholarships through the need-based tuition that all public and some private institutions charge and the more traditional discounts provided through most private institutions. But in a country that charges relatively high tuition, this level of coverage from both scholarships and loans is insufficient to meet the absolute lack of resources of economically disadvantaged students as well as the cash flow needs of many middle class students.

- **Regressive Distribution of Benefits.** The overall financing structure for higher education and the distribution of benefits in Colombia is slanted towards the middle class for three related reasons: First, virtually all government funding for higher education is directed at direct support of institutions. To the extent that middle and upper class students constitute most of the student enrollments (as in the case in almost all countries), this is a regressive way of allocating government funds. Second, a large proportion of the very small amount of student aid that is provided is devoted to credit rather than scholarships. More than 95 percent of all student aid in Colombia is provided in the form of credit that is largely provided to students from middle class families. Third, the traditional limits in lending in Colombia, particularly by the banks to credit worthy students (to keep repayment rates high), means that low income students receive relatively little in the way of aid.

- **Lack of Liquidity.** Although the student credit system in Colombia is well established, it has suffered from a chronic lack of liquidity that has served as a major constraint on its capacity to grow. The traditional reliance of ICETEX on the government to provide financing for student credit has been the most important reason that the volume of lending has declined in recent years as the government reduced and then eliminated its support. The absence of a secondary market (second floor bank) also has been a principal factor in preventing private banks from moving beyond the provision of short-term credit. (The other constraint on banks providing longer term credit has been an inadequate guarantee arrangement which has been addressed by the recent entrance of Fondo Garantias into the student credit market.)
Problems and Challenges to Colombian Higher Education Addressed by the Proposed Reforms in Student Financial Aid

The sector analysis identifies a number of problems and challenges that Colombian higher education now faces, including:

- Inadequate quality as measured by growth over time in the number of low quality programs of study, particularly in the private sector where quality is highly variable.
- A lack of relevance as indicated by a mismatch between what Colombian students study and the needs and the requirements of the labor market.
- Barriers to access as indicated by an overall decline in enrollments since 1997 and a continuing gap in higher education participation rates between rich and poor students.

International experience suggests that student aid programs, including credit programs, can only have limited impact on meeting the challenges indicated above. Moreover, in a number of countries, student aid policies and programs often contribute to problems such as reduced quality. For example, student aid often is a factor in the decline in quality as inferior schools or programs gain eligibility to financial aid for their students. So a critical question is whether the new aid scheme in Colombia will be used to improve quality or will it have the effect of reducing quality.

How could student aid reforms be used to address the challenges of improving quality, relevance, and access faced by Colombian higher education? Several possibilities exist:

**Improving Quality.** Student aid programs could be used to improve quality by limiting eligibility for student aid to those students enrolling in programs of study deemed to be of high quality through a modified and expanded accreditation process, as described in the annex on accreditation in this sector analysis.

One particular aspect of possible accreditation reform should be noted in this context. An accreditation process that focuses on reviewing programs of study more so than a full institutional review would be particularly amenable to integration with a process that uses student aid as a mechanism for improving quality. A program-based process for accreditation would allow for much greater targeting of government-funded aid on quality programs than the more common institution-based accreditation which permits much less flexibility in assessments of different programs within one institution.

**Improving Relevance.** To improve the relevance of government policies, eligibility for student aid could be limited to students enrolling in fields of study deemed to be of high priority by the government in consultation with various stakeholders. As a means for targeting scarce government resources, a number of countries limit eligibility for all or portions of student aid to fields of study deemed to be of high priority. These efforts take many forms, but a worthwhile way of proceeding is to engage relevant government
agencies – finance, planning, economic development as well as education – and a range
of stakeholders in the process of identifying high priority fields of study based on
economic, demographic, and societal assessments of need. A program-based
accreditation process, as described above, would dovetail well with efforts to identify
priority fields of study.

**Improving Access.** Student aid in most countries, of course, is typically employed as a
means for improving access and this should certainly be the case in Colombia as well.
One obvious way to utilize student aid to improve access is to increase the availability of
scholarships (scholarships) which currently account for a very small portion of
government funding of higher education in Colombia. Given scarce resources, however,
it is not realistic to provide scholarships to a broad range of students. As a means for
targeting resources, scholarships could be substantially expanded for students who
demonstrate both high merit and high need.

In addition, expanded student credit could be used to increase access by increasing the
ability of a broad range of students to pay for higher education. Coverage of student
credit has declined in the past decade, mostly as a result of the drying up of government
funding for loan capital. Given scarce resources, it is not realistic to expect the
government to resume its role in earlier decades of providing large amounts of loan
capital directly to ICETEX or any other student credit effort. But this does not preclude
using private capital to fund an expansion of student credit in Colombia.

**The Appropriate Mix Between Student Financial Aid and Direct Support of
Institutions?**

In assessing the efficacy of a country’s student aid structure, it is not sufficient simply to
examine the policies and the operation of the student aid programs themselves. Each
country should also examine its student aid structure in the broader framework of how its
higher education system is currently financed and how it should be financed in the future
to maximize its effectiveness. This broader set of questions relate to the four components
of higher education finance: government funding of institutions; the setting of tuition and
fees; providing financial aid to students; and ensuring adequate quality of programs and
effective management of institutions.

In reviewing the higher education financing structure in Colombia, several characteristics
are important to note in this regard:

- Overall level of support for higher education is relatively low – less than 1
  percent of GDP is devoted to higher education.
- Almost all public funding for higher education is provided directly to institutions
  -- less than one percent of total government funding for higher education is
  devoted to student financial aid. This figure is deceptive, however, in that the
  principal source of aid in Colombia is the discounts that both public and private
  institutions provide to their students.
Tuition and fees at public institutions are set on a need basis and represent a major source of student financial aid. Need-based tuition ranges from less than the minimum salary to three to four times minimum salary. On average, public tuition and fees cover about half of costs per student.

Tuition and fees in private institutions range from $300 to $2,000 per year and on average constitute about 70 percent of all revenues. Most private institutions charge a fixed amount for tuition, although some continue to charge on a need-basis similar to the public institutions in Colombia. The discounts that private institutions represent the major source of student aid in Colombia.

Despite representing a small share of all government spending for higher education, a review of the past half century indicates that student aid has played an important role in the development of Colombian higher education. Need-based tuition policies have effectively provided scholarships for many thousands of students, but the government has very little control over who receives scholarships. There is also very little data on the amount of aid provided through need-based tuition and discounts and which students receive the benefit of these subsidies.

Credit has played a relatively important role in the financing of Colombian higher education, compared to the role that student loans play in most other countries. ICETEX is among the oldest student loan programs in the world and is often viewed as a model for other countries to emulate in making credit available to their students. But the coverage of ICETEX is relatively low and the current structure is inadequate to accommodate the large-scale expansion that is being contemplated as part of this project.

Bank-based student loans have become more commonplace in recent years, in part to meet the unmet demand for credit created by the low coverage of ICETEX. These bank-based efforts have exhibited a healthy degree of innovation and merit serious consideration as part of any reform effort. But coverage through bank-based student credit is also low and generally has been limited to more credit-worthy middle income students.

One of the first issues that policymakers thus ought to address as part of any overall reform effort is what level of government support will be available in the future for student financial aid. Any realistic assessment of the current situation suggests that the share of government funding devoted to student aid should be increased as part of any reform effort. This would allow for greater student choice than under the current system in which virtually all government funds are funneled through institutions.

The Appropriate Mix Between Scholarships and Credit?

One of the most striking characteristics of the current aid structure in Colombia is how slanted it is toward credit. While need-based tuition provided by public and private institutions is an important form of scholarship assistance, virtually all of the financial support that is provided or sponsored by the government to students is via ICETEX or
bank-based loans. This is unusual in that the governments in most countries typically are not so committed to credit and provide a more substantial degree of non-repayable assistance in the form of grants, bursaries, scholarships, fellowships, or scholarships.

This Colombian tradition of relying on credit is commendable in a number of ways, including having students pay for the private benefits of their higher education and allowing institutions to charge higher fees, thereby increasing resources devoted to higher education and ultimately increasing access to higher education. This is not a point well understood in many countries where students protest the imposition of fees as a barrier to access. The fact is that countries which charge higher fees tend to have higher participation rates in higher education than those countries which charge little or no fees, precisely because of the supply enhancing effect of higher fees creating more resources. To the extent that the availability of student credit allows institutions to charge higher fees, it can rightly be characterized as an access enhancing policy.

Nonetheless, a financial aid system that relies entirely on credit can serve as an obstacle for increasing access for many of the students for whom the assistance is most intended – students from the most impoverished families. The experience in the United States and the growing number of countries that have come to rely more on student credit as a form of assistance suggests that the students from the lowest income families are the ones most dissuaded from attending because of concerns about incurring debt. Their parents are the ones most inexperienced in taking on debt as well as being the ones least likely to repay. Prospective debt burdens can also be an inhibiting factor at the graduate level as students will be disinclined to borrow especially in those fields where incomes are not high enough on average to repay what had been borrowed in a timely and manageable fashion.

This international experience suggests that credit should not be the sole focus of reform proposals in Colombia since credit is typically not a good vehicle for improving access for the lowest income students. To achieve greater access, particularly for low income students, the new aid structure should shift somewhat toward a greater emphasis on nonrepayable assistance. One possible formulation along these lines would be to:

- Establish a government scholarship program for undergraduate students with high need and high merit. A scholarship program for undergraduates that focuses on both need and merit would signal the government’s commitment to use student aid both to improve quality and access for students who face the most substantial financial and other barriers to their increased participation in higher education.
- Expand the availability of credit for students who meet basic levels of need and merit. Expanded availability of student credit could stimulate increases in overall student access by allowing a range of students to borrow to help pay their fees at both public and private institutions. A reasonable medium term goal would be to raise coverage levels in student credit from the current level of less than 10 percent of all students borrowing to perhaps 20 percent. This will require a substantial increase in loan capital discussed under question G of this annex.
Create a program of fellowships and assistantships for doctoral candidates in selected fields of study. Another chronic problem in Colombian higher education is the difficulty in attracting students to enroll in graduates programs of critical importance. Credit programs are not a good way to stimulate such behavior if after-graduation incomes are not high enough to support repayment of the loans. Fellowships and/or assistantships for students who enroll and complete their doctoral programs would be a more positive approach for addressing the problem of stimulating demand for critically-needed doctoral programs.

Within this proposed framework for reform, designers of a new or revised system of aid will need to address the following questions:

- What should be the relative emphasis on need and merit?
- Should the existing criteria for determining be retained or changed?
- Which students should be eligible for scholarships? Which to borrow?

Need-based Discounts and Scholarships Versus a Voucher-System?

In addition to the reliance on credit as discussed in the preceding section, another unusual aspect of financial aid in Colombia is the relatively small role that the government has traditionally played in the provision and administration of scholarships. The traditional role of the government has been to rely on institutions to provide aid primarily through need-based tuition policies at public institutions and more traditional discounting at private institutions. A question that Colombian policymakers need to address is whether it is feasible to expand the provision of scholarships within the existing framework of institution-based assistance or whether the government needs to play a more active role in identifying and funding scholarship recipients.

One of the chief advantages of maintaining the current decentralized scholarship structure is that it minimizes the need for government staffing and costs. Virtually all of the costs are borne by the higher education institutions themselves. This type of administrative structure also allows institutional officials, who are closest to knowing the situation of individual students, to make informed decisions about which of their students most require and would benefit from the assistance being provided.

The principal disadvantage of continuing with the decentralized aid structure is that government policies may be countered by institutional decisions. For example, to the extent institutions are providing scholarships principally to middle class students as a means for recruitment, then the intent of focusing the most nonrepayable aid on the poor has been subverted. Similarly, to the extent there is widespread ‘cheating’ in the reporting of income by students and their families and the lack of a standard procedure for calculating student need, the effectiveness of the student aid structure is undermined.
Student aid programs that operate more like vouchers hold the advantage of providing students with a more effective choice of institutions than institution-based aid programs. On the other hand, voucher-like programs require a more extensive administrative structure than many governments have the capacity to provide. This then becomes the advantage of an institution-based aid system in which institutions shoulder the burden of administering the system and assume much of the administrative costs in exchange for being given a large degree of discretion in how public funds are to be distributed.

As an integral part of any reform effort, government policymakers in Colombia should be willing to consider this question of whether to continue to rely on the traditional decentralized approach of providing scholarships through the institutions, or to establish a more substantial governmental role for nonrepayable assistance, either in the form of increased levels of funding or in dictating to institutions how to distribute the aid they provide.

One such expansion of the government role would be for it to become more involved in determining which students receive scholarships or fellowships without providing much if any more in the way of government funding. This result could be achieved by the government establishing rules for how institutions should administer their need-based tuition or discounts. There is certainly precedent for this. In the Philippines, for example, the government requires that private institutions provide aid to 5 percent of their students as a condition for maintaining their non-profit status and not being taxed. This provision has not been very successful in the Philippines because there is no requirement that the aid recipients be needy and as a result the aid is not well targeted. But such a requirement could be tightened to focus aid more on the most disadvantaged students.

A more extensive government role would entail establishing a government-funded program that was designed either to run through the institutions or to operate more like a voucher. In taking such a decision, there should be a recognition that institution-based student aid structures tend to be easier to administer but are less effective at providing choice to a broad range of institutions and require greater governmental monitoring of institutions than voucher-like programs. The shift to a voucher-like structure, however, could entail a substantial effort both in terms of resources and effort.

**Built Entirely New Credit Structure or Develop Existing Structure?**

Perhaps the most important issue that must be addressed in short order in redesigning student financial aid in Colombia is whether the future student credit system should be based on the existing structure or whether a new system is needed. In most countries, the answer to this question would be easy to provide: a new system would be needed because high default rates and ineffectual administrative systems require a rethinking of what has been done in the past.
In Colombia, this question is more difficult to answer than in most other countries because ICETEX is among the oldest student loan programs in the world and its record of repayment is well above average. These conditions of long experience, ICETEX’s well established reputation both within Colombia and as a model for other countries, and a reasonable history of repayment are all strong reasons for building a new student loan program on the foundation of the existing one.

There are reasons, however, to consider starting from scratch and building a new student loan program rather than rely on ICETEX. One reason is that in the course of developing this sector analysis and this annex it became obvious that ICETEX has its problems. Relatively simple data requests required much too long response times suggesting that record keeping and data analysis are lax within the organization. There are concerns that administrative costs are high, although a lack of reliable data make it difficult to ascertain the extent of this problem. The growth in bank-based loans in recent years also suggests that the ICETEX structure is not adequate to meet current needs, let alone new ones.

On balance, it seems advisable to build reforms on the existing structure of ICETEX and bank-based loans than to create an entirely new structure. ICETEX is too well regarded politically and too well established in the mind of the public to move away from it being an important component of any new student credit scheme. The two banks that currently make student loans also have behaved well in trying to fill gaps in the existing structure and deserve a chance to continue participating. In short, there is too much good and goodwill with what exists to justify the risks of going in some entirely different direction.

The question then becomes what reforms are needed to the existing student credit structure to make it more effective and more capable of meeting sharply increased demands. The obvious answer is the need for a secondary market (second floor bank) for student loans in Colombia. ICETEX’s capacity to lend has declined sharply in the past decade because the government has withdrawn its direct provision of loan capital and there has been no effective alternative source of capital. By the same token, the banks have been limited in their ability to offer anything more than short-term credit because of the lack of a secondary market to provide greater liquidity.

The experience in the United States is instructive in this regard. In 1972, the Student Loan Marketing Association (Sallie Mae) was created through federal legislation as a private corporation to serve as a secondary market for the then small federally guaranteed student loan program. In this program, private banks made student loans that were fully guaranteed through a combination of state guarantee agencies and federal reinsurance. Banks that participated in the program argued that they were limited in how much they would lend because of the absence of a secondary market. The Congress responded by creating Sallie Mae as a federally chartered for-profit corporation as a secondary market for student loans that could both issue stock and incur debt to finance its operations.
As a federally chartered corporation, Sallie Mae enjoyed certain benefits over other corporations, including access to a “window” at the U.S. Treasury that lent to a small group of federally sponsored corporations at favorable rates (50 basis points or less over the treasury rate on comparable paper). In the past decade, Sallie Mae has privatized to allow it to broaden its charter beyond student loan activities and as a result no longer has access to preferential borrowing from the Treasury.

The initial purpose of Sallie Mae was two-fold: First, it could buy loan paper from banks or other loan holders as a way to create additional liquidity or it could “warehouse” loans by lending to banks that would use their student loan paper as collateral. In the intervening three decades, the activities of Sallie Mae have greatly expanded. It is now among the largest servicers of student loans, both of the loans it holds and as a contract servicer for loans held by others. Sallie Mae also aggressively entered the financial markets and has become an important player in hedging and securitization activities.

Since it was created, Sallie Mae has come to be a dominant force in the U.S. student loan industry (now holding more than one-third of all outstanding student loan paper), although a number of other secondary markets also exist to meet market needs. Collectively, all the student loan secondary markets hold perhaps one-half of all outstanding student loan paper.

The experience of Sallie Mae and other secondary markets in the U.S. suggests the potential benefits of Colombia of considering this approach. It is not a coincidence that student loan volume in the U.S. has grown roughly $1 billion to nearly $50 billion in the three decades since Sallie Mae was created. While there are many reasons that loan volume has grown in that time, the existence of a viable secondary market is undoubtedly a key one.

Policymakers in Colombia need to consider the experience of Sallie Mae and other secondary markets in the U.S. and elsewhere in their own context. Whether a second floor bank should be federally chartered or privately created is one key question. Whether ICETEX could serve its traditional role as well as being a second floor bank or whether some other existing or new organization can best serve this role is another key question. But what should not be lost in this conversation is the potential importance of creating greater liquidity for student credit in Colombia through a secondary market.

Whatever group or organization is assigned the responsibility for serving as a secondary market, private investors such as pension funds and individuals must be relied as a source of financing and should be assured a competitive return on investment. A description of how such a system might work in Colombia is provided in Chart 2. In terms of the roles of various organizations already involved in providing credit in Colombia, the following structure might be contemplated:
The role of the government under the reforms proposed in this annex would be two-fold: 1) to establish through legislation and to provide start up funding for a student credit secondary market (second floor bank) to provide greater liquidity and 2) to provide a guarantee fee to ICETEX for new loans that it makes directly to students. International experience suggests this guarantee fee should be paid upfront as a percentage of loans guaranteed rather than as an open-ended commitment that would guarantee lenders or note holders a portion of losses on all loans made. Upfront fees are controllable and therefore limit budgetary exposure, whereas open-ended guarantees, even if on only a portion of defaulted loans, subject the government or other guarantors to a risk that few governments can undertake responsibly.

The role of ICETEX would be: 1) to continue making and servicing loans to students who do not meet credit worthiness standards in the bank-based program, and 2) to possibly become a secondary market for both bank loans as well as those made by ICETEX. If ICETEX were to become a secondary market, however, its role as a public entity would become more blurred because it would now be using private investor funds to finance its second floor banking activities. It is our assessment based on the experience in preparing this project analysis that some organization other than ICETEX should take on the responsibilities of being a second floor bank.

The role of commercial banks in providing student credit would continue largely as it is now - to lend to credit worthy student borrowers and to service those loans. Bank-based loans, though, would expand beyond the traditional role of providing of short-term credit because the creation of a secondary market would allow for longer terms. The existence of a viable secondary market would also stimulate the entrance of other commercial banks into student credit beyond the two banks currently engaged.

The role of Fondo Guarantia in student crediting would also remain largely as it now is – to guarantee a portion of the loans made by the private banks with which it has agreements, although its mix of student credit would shift to longer term instruments.

The role of HE institutions would be to accept less than the face value of the loan as payment for an equivalent amount of tuition fees. This would be key for allowing student borrowers to be charged an interest rate below market conditions in a largely privately-financed system of student credit. This kind of arrangement requires that 1) the loan proceeds be distributed to institutions while the credit note is obviously signed by the student and/or parents, and 2) that credit be limited to tuition and other fees charged by the institution and not to general living expenses of the student.
The administrative structure suggested above or others that policymakers in Colombia may wish to consider is not determinative of many other features of a student credit program that would have to be decided under any reform effort. These issues include:

- Student and institutional eligibility for credit.
- Interest rates and other loan terms and conditions.
- Repayment terms, including the possibility of income contingent schedules.

These design issues will be critical to the success of any effort in Colombia to reform student aid and to improve the financing of higher education overall. Once key structural decisions are taken, such as the shape and structure of a second floor bank, then these design issues of eligibility, subsidies, and repayments, will have to be addressed.
<table>
<thead>
<tr>
<th>No.</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Van der Gaag &amp; Winkler, <em>Children of the Poor in Latin America and the Caribbean</em></td>
</tr>
<tr>
<td>2</td>
<td>Schneidman, <em>Targeting At-Risk Youth: Rationales, Approaches to Service Delivery and Monitoring and Evaluation Issues</em></td>
</tr>
<tr>
<td>3</td>
<td>Harrell, <em>Evaluación de los Programas para Niños y Jovenes Vulnerables</em></td>
</tr>
<tr>
<td>4</td>
<td>Potashnik, <em>Computers in the Schools: Chile’s Learning Network</em></td>
</tr>
<tr>
<td>5</td>
<td>Barker &amp; Fontes, <em>Review and Analysis of International Experience with Programs Targeted on At-Risk Youth</em></td>
</tr>
<tr>
<td>6</td>
<td>Lewis, <em>Measuring Public Hospital Costs: Empirical Evidence from the Dominican Republic</em></td>
</tr>
<tr>
<td>7</td>
<td>Edwards, Bruce, &amp; Parandekar, <em>Primary Education Efficiency in Honduras: What Remains to be Done?</em></td>
</tr>
<tr>
<td>8</td>
<td>Winkler, <em>Descentralización de la Educación: Participación en el Manejo de las Escuelas al Nivel Local</em></td>
</tr>
<tr>
<td>9</td>
<td>Meza, <em>Descentralización Educativa, Organización y Manejo de las Escuelas al Nivel Local: El Caso de El Salvador</em></td>
</tr>
<tr>
<td>10</td>
<td>Espinola, <em>Descentralización Educativa, Organización y Manejo de las Escuelas al Nivel Local: El Caso de Chile</em></td>
</tr>
<tr>
<td>11</td>
<td>Guedes, Lobo, Walker, &amp; Amaral, <em>Gestión Descentralizada de la Educación en el Estado de Minas Gerais, Brasil</em></td>
</tr>
<tr>
<td>13</td>
<td>Bedi &amp; Edwards, <em>The Impact of School Quality on the Level and Distribution of Earnings: Evidence from Honduras</em></td>
</tr>
<tr>
<td>14</td>
<td>Duthilleul, <em>Do Parents Matter? The Role of Parental Practices on Fourth Graders’ Reading Comprehension Achievement in Montevideo Public Schools</em></td>
</tr>
<tr>
<td>15</td>
<td>Villegas-Reimers, <em>The Preparation of Teachers in Latin America: Challenges and Trends</em></td>
</tr>
<tr>
<td>16</td>
<td>Edwards &amp; Liang, <em>Mexico’s Preschools: Coverage, Equity and Impact</em></td>
</tr>
<tr>
<td>17</td>
<td>Soares, <em>The Financing of Education in Brazil: With Special Reference to the North, Northeast and Center-West Regions</em></td>
</tr>
<tr>
<td>18</td>
<td>Salmi, <em>Equity and Quality in Private Education: The Haitian Paradox</em></td>
</tr>
<tr>
<td>19</td>
<td>Waiser, <em>Early Childhood Care and Development Programs in Latin America: How much do they cost?</em></td>
</tr>
<tr>
<td>20</td>
<td>Tulic, <em>Algunas Factores del Rendimiento: Las Expectativas y el Género</em></td>
</tr>
<tr>
<td>21</td>
<td>Delannoy, <em>Reformas en Gestión Educacional en los 90s</em></td>
</tr>
<tr>
<td>22</td>
<td>Barro, <em>The Prospects for Developing Internationally Comparable Education Finance Statistics for Latin American Countries: A Preliminary Assessment</em></td>
</tr>
<tr>
<td>23</td>
<td>El-Khawas, DePietro-Jurand, &amp; Holm-Nielsen, <em>Quality Assurance in Higher Education: Recent Progress; Challenges Ahead</em></td>
</tr>
<tr>
<td>25</td>
<td>Rojas &amp; Esquivel, <em>Los Sistemas de Medición del Logro Académico en Latinoamérica</em></td>
</tr>
</tbody>
</table>
No. 26 Martinic, Tiempo y Aprendizaje
No. 27 Crawford & Holm-Nielsen, Brazilian Higher Education: Characteristic and Challenges
No. 28 Schwartzman, Higher Education in Brazil: The Stakeholders
No. 29 Johnstone, Institutional Differentiation and the Accommodation of Enrollment Expansion in Brazil
No. 30 Hauptman, Accommodating the Growing Demand for Higher Education in Brazil: A Role for the Federal Universities?
No. 31 El-Khawas, Developing Internal Support for Quality and Relevance
No. 32 Thélot, The Organization of Studies in the French University System
No. 33 Thompson, Trends in Governance and Management of Higher Education
No. 34 Wagner, From Higher to Tertiary Education: Evolving Responses in OECD Countries to Large Volume Participation
No. 35 Salmi & Alcalá, Opciones para Reformar el Financiamiento de la Enseñanza Superior
No. 36 Piñeros & Rodriguez, School Inputs in Secondary Education and their Effects on Academic Achievement: A Study in Colombia
No. 37 Meresman, The Ten Who Go To School
No. 38 Vegas, Pritchett, & Experton, Attracting and Retaining Qualified Teachers in Argentina: Impact of the Level and Structure of Compensation
No. 39 Myers & de San Jorge, Childcare and Early Education Services in Low-Income Communities of Mexico City: Patterns of Use, Availability and Choice
No. 40 Arcia & Belli, Rebuilding the Social Contract: School Autonomy in Nicaragua
No. 41 Plomp & Brummelhuis, Technology in Teacher Education: The Case of the Netherlands
No. 42 Winter, Secondary Education in El Salvador: Education Reform in Progress
No. 43 Wu, Maiguashca, and Maiguashca, The Financing of Higher Education in Ecuador
No. 44 Salmi, Student Loans in an International Perspective: The World Bank Experience
No. 45 Ravela & Cardoso, Factores de Eficacia de la Escuela Primaria en Contextos Sociales Desfavorecidos: La experiencia de Uruguay
No. 46 Experton, Desafíos para la Nueva Etapa de la Reforma Educativa en Argentina
No. 47 Fiszbein, Institutions, Service Delivery and Social Exclusion: A Case Study of the Education Sector in Buenos Aires
No. 48 Gasperini, The Cuban Education System: Lessons and Dilemmas
No. 49 Liang, Teacher Pay in 12 Latin American Countries
No. 50 Brunner & Martínez, Evaluación Preliminar y Metodología para la Evaluación de Impacto del FOMEC en Argentina
No. 51 Koshimura & Tsang, Financing Strategies for Equalization in Basic Education
No. 52  Koshimura, High Standards for All Students: Excellence or Equity?
No. 53  Goldschmidt & Wu, Determinants of Achievement in Peru
No. 54  Cohen, Public Policies in the Pharmaceutical Sector: A Case Study of Brazil
No. 55  Vakis & Lindert, Poverty in Indigenous Populations in Panama: A Study Using LSMS Data
No. 56  Salvi, Violence, Democracy and Education: An Analytical Framework
No. 57  Cotlear, Peru: Reforming Health Care for the Poor
No. 58  Newmann, Chile: Rol del Estado: Políticas e Instrumentos de Acción Pública en Educación Superior
No. 59  Winkler & Gershberg, Education Decentralization in Latin America: The Effects on the Quality of Schooling
No. 60  Eichler, Financing Health Care for the Elderly in Competitive Health Plan Markets: Experiences from the United States and the Netherlands and Proposals for Reform
No. 61  Mintz, Managing Acute, Chronic, and Catastrophic Health Care Costs: Experience and Policy Issues in the Context of US Managed Care and Comparative Analysis of the Chilean Regulatory Framework
No. 62  Salmi, Tertiary Education in the Twenty-First Century: Challenges and Opportunities
No. 63  Lopez-Acevedo & Salinas, Teacher Salaries and Professional Profile in Mexico
No. 64  Lopez-Acevedo, Professional Development and Incentives for Teacher Performance in Schools in Mexico
No. 65  Londoño, Jaramillo, Uribe, Descentralización y reforma en los servicios de salud: El caso colombiano
No. 66  Bovbjerg, Covering Catastrophic Health Care and Containing Costs: Preliminary Lessons for Policy from the U.S. Experience
No. 67  Alvarez & Majmudar, Teachers in Latin America: Who is preparing our children for the knowledge century?
No. 68  Reyes, Colombia: Decentralized Education Management
No. 69  Maria Jose Lemaitre & Daniela Torre, Chile: Manual para el Desarrollo de Procesos de Autoevaluación
No. 71  Jose Joaquin Brunner, Colombian Higher Education in the Context of Reform in Latin America
No. 72  Robin DePietro-Jurand & Maria Jose Lemaitre, Quality Assurance in Colombia
No. 73  Natalia Agapitova, Goga Vukmirovic, and Lauritz B. Holm-Nielsen, Science and Technology in Colombia: Status and Perspectives
No. 74  Isabel Cristina Jaramillo, Patricia García Záñiga & Andreas Blom, Colombian Higher Education in the Global Market
No. 75  Andreas Blom & Thomas Hansen, Economic Perspectives of Tertiary Education: The Case of Colombia
No. 76  Arthur Hauptman, Reforming Student Financial Aid: Issues and Alternatives