

Conventional Fixed-Schedule versus Income Contingent Repayment Obligations: Is there a *Best* Loan Scheme?

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Abstract: As more countries are planning to inaugurate or enlarge student loan schemes, much of the debate is over the question of the optimal form of the repayment obligation: specifically, whether it should be according to a fixed schedule of payments or a percentage of earnings or income. This paper argues that the current fascination with income contingency is frequently based on a set of supposed advantages, some of which are mistakenly attributed to income contingency either out of misunderstanding on the part of advocates or for political purposes of overcoming resistance to the underlying notion not of loans, per se, but of cost-sharing itself. The paper goes on to advocate a hybrid loan scheme, which can offer the best of both forms of repayment obligation.

Student loan schemes have become widespread throughout the world; Shen and Ziderman (2007) reported some 75 in 2007. By the term *loan scheme*, we mean a program, in most cases involving governmental sponsorship, that covers some portion of instructional or student maintenance costs or both and that results in a repayment obligation, whether this obligation is actually called a loan or by some euphemism (such as a *graduate tax*) and whether the obligation is to a fixed schedule of payments or is expressed as some percentage of the borrower's future income or earnings.

Some schemes are small: severely rationed by limited loan capital, or sponsored only by a single institution or consortium of institutions (generally private), or focused only on low-risk borrowers such as advanced professional students or borrowers who can produce multiple, credit-worthy co-signatories. A few schemes, including several in Africa, are financially fragile and have little record as yet of repayment recovery. The largest schemes, found in advanced industrialized countries like the United States, Canada, Japan, Korea, Australia, The Netherlands, Sweden, Norway, Germany, and the constituent countries of the United Kingdom, are *generally available*, meaning that all or nearly all students are entitled to a loan of some sort. However, while the importance of student loans seems bound to increase, and while student loan schemes are on the political table in many more countries, any scheme that is *generally available* requires considerable governmental involvement—which may include any or all of the setting of rates and terms, the provision of subsidies, the provision of capital, the assumption of risk, and/or the actual origination and servicing of the loans—and student loan schemes may therefore be resisted both by ministers of finance, who may fear their financial cost to the treasuries, as well as by students, who may fear the encroachment of tuition fees (Johnstone, 2004a, 2005, 2006a).

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Student loan schemes are also complex, widely misunderstood, sometimes misrepresented, and frequently contested—although the political and ideological opposition tends to be aimed less at the notion of student borrowing itself than it is at a presumption that a governmental loan scheme is a kind of camel’s nose into the tent of cost-sharing (Johnstone 2004a). This paper examines the complexity of the forms and aims of student loans and in so doing attempts to shed a bit of light on what has come to be a question that is, perhaps ironically, important less in its own right, but because it is so widely misunderstood and sometimes misrepresented that it has become, at least arguably, a distraction to good policy analysis (Johnstone 2004b). This is the question: is there a *best* student loan scheme as between a *conventional fixed schedule* and an *income contingent* repayment obligation (the latter being an increasingly popular form in which the repayment obligation is expressed as a percentage of income or earnings)?

To anticipate our conclusion, we prefer neither—or rather both: that is, our preference is for what we have called the *hybrid* version that contains elements of both fixed schedule and income contingent repayment obligations (Johnstone, 2004b, 2004c, 2005). This is not an opposition to income contingency per se, and especially not to the essence of this form of obligation, which is to provide better protection against repayment burdens becoming unmanageable. However, we are opposed to the *overselling* of income contingency—in particular, the attribution of certain favorable student loan features to income contingency when they can as easily be attached to loans of a more conventional variety, including the above-mentioned hybrid version of a repayment obligation. We object even more to the promotion of the income contingent form of repayment obligation in countries where incomes are too frequently not recorded, easily hidden, paid under the table, or easily shifted among family members.¹ And even in the industrialized countries of the EU or the OECD, where a financially viable income contingent loans scheme is more technically feasible, there are problems (or at least complexities) of income definition, income shifting, emigration, cross border employment, access to capital markets, and threats to voluntary income reporting and tax collection that have not always been sufficiently addressed by its proponents.

Forms of Student Loan Repayment Options

Let us first identify with greater precision what differentiates the student loan forms under question: that is, the conventional or fixed schedule, the income contingent, and the so-called hybrid form of repayment obligation.

1. *The fixed-schedule (or conventional, or mortgage-type) loan:* In a fixed schedule, or conventional, mortgage-type loan, the monthly schedule of repayments, the interest rate, and the repayment period are all fixed in the contractual repayment

¹ Income contingent loans are attractive in developing countries because there is usually violent opposition to the imposition of cost-sharing, and an income contingent repayment obligation—especially one that never passes through the hands of the students but is merely left as a sort of *income surtax*—is thought to be more politically acceptable. However, the incidence of repayments in such schemes falls mainly on civil servants and employees of larger corporations, whose incomes are known and whose repayments can be verified. Thus, just as large amounts of income in the larger economy are unreported and generally undiscoverable for the purpose of income taxation, so large amounts of loan repayments are likely also to go undiscovered and unpaid, jeopardizing both the financial viability and the fairness of the loan scheme (Johnstone, 2004c).

agreement, or loan note. What would vary—mainly according to the income of the borrower, including periods of low or no income as in unemployment—would be the annual *burden* of the payments, which would depend on the initial size of the debt, the interest rate, the repayment period, and how the resulting monthly payment compared to the borrower’s monthly or annual income.

2. *The income contingent loan:* The second common form of student loan is the income contingent (or income-related, or contingent repayment) loan. In an income contingent loan, what is fixed is the monthly or annual repayment burden (at least as far as the *burden* is appropriately thought to be measured by the monthly or annual percentage or income or earnings required for repayment) along with the interest rate (which most borrowers will end up paying in full and which would presumably be the same as in the conventional fixed-schedule option). What would vary—again as a function mainly of the level of income, or earnings—would be *the repayment period* for those who eventually repay their loans in full as well as *the ultimate cost of the loan* for some number of lifetime low-earning borrowers who will end their repayment obligations never having fully repaid their loans. (See Johnstone 1972, Barr 2001, Chapman 2006a, Chapman 2006b.)

3. *The hybrid fixed schedule-income contingent loan*². In a hybrid, or fixed schedule-income contingent loan, the underlying, or default, obligation would be a fixed schedule of payments that would be due unless the monthly or annual repayments exceeded some maximum percentage of monthly or annual earnings (Johnstone 2004b, 2005, 2006a). In that event, amounts owed in excess of this threshold would be deferred (and the interest compounded). Borrowers, experiencing a year or two of low income due to unemployment, for example, would pay *income contingently* during these years, but return to the fixed schedule of repayment obligations on their remaining debt—augmented by any deferred obligations—when they regained their employment and their earnings. In this way, borrowers able to demonstrate their inability to make current repayments would be granted the convenience of automatic deferment of some or all of these current repayments: similar to a *refinancing*, but not a *subsidy*, as such. However, those borrowers who combined prolonged periods of unemployment or a low paying job with high initial indebtedness might continue to repay their student loans on an income contingent basis, reaching the end of the original underlying repayment period with remaining indebtedness—which at some point would be forgiven as though the entire student loan obligation had been income contingent from the beginning.

The Critical Elements of a Governmentally-Sponsored Student Loan Scheme

The form of the repayment obligations is one of the questions that must be answered in the design of a student loans scheme. It is, however, only one of a number of critical policy decisions that must be made in the design of a loan scheme, and it is by no means the most important or central. Thus, the preoccupation with the form of the repayment obligation can distract policy makers from the many other critical elements in the design of a governmentally-sponsored student loan scheme—which are the following eleven:

² Alex Usher calls this form *soft income contingency*. See Usher, *Much Ado About a Very Small Idea*. Toronto: Educational Policy Institute, 2005.

1. *The place of the student loan scheme or schemes in the total array of policy elements making up the complex sharing of higher educational costs:* These policy elements include: (a) tuition fees (if any); (b) the officially expected division of any such tuition fees among parents (up-front fees), students (deferred fees), and taxpayers (fees assumed for some or all students by the government); (c) the similar division of student living expenses among parents, students, and taxpayers; and (d) all grants or bursaries, including the hidden grants of subsidized loans. Taken together, this combination of financial assistance *cum* tuition fees determines whether the beneficiary of the loan scheme is to be government, parent, student, a single institution, a higher educational system, or a mix of beneficiaries.
2. *The aim of the loan scheme:* The possible aim or aims of the loan scheme[s] within this complex of policy elements include: (a) supporting a measure of cost-sharing, (b) putting money into the hands of all or most students, (c) putting money into the hands of low income students and increasing accessibility and participation; (d) rewarding *good* students (by whatever measure); (e) allowing students to become financially independent of their parents; (f) providing a cost-effective governmental subsidy to a private tuition-dependent sector; and (g) affecting post-graduation behavior by subsidizing (in the form of repayment forgiveness) those borrowers who practice certain professions and/or in certain *high-need* venues (such as teaching in a remote area). (See Ziderman, 2002.)
3. *The degree of subsidization:* The degree of discretionary, or governmental, interest subsidization determines the true cost of the loan (by the discounted present value of the repayments) to the borrower, as well as the cost of the loan to the government, or taxpayer (again in discounted present value). In policy theory, such subsidies should be compared in their efficacy to alternative uses of the same limited governmental funds in pursuit of similar aims—such as outright non-repayable grants or lower tuition fees to all students.
4. *The method of rationing or targeting;* specifically, whether loans are allocated by the criterion of financial need (principally, at least for undergraduates, by the income of their parents) or on other criteria such as academic merit, or credit-worthiness, or choice of academic program. Rationing, or targeting, is essential to link the disbursement of the loans and the expenditure of subsidies to the aim or the aims of the program.
5. *The volume of new lending made available:* The method as well as the severity of rationing will be influenced by the volume of loans to be made available. For need-based lending, for example, the critical link between the volume made available and the method of rationing is whether, in the event of insufficient volume of new loan capital, the insufficiency is “solved” by reducing the amounts of all loans (that is, cutting a little or a lot from each) or by rationing more severely (that is, meeting the needs of the poorest and neediest borrowers first).

6. *Default risk:* As generally-available student loans³ carry a high element of risk, this risk has to be borne by one or more of the following: (a) co-signatories, (b) government, (c) the higher educational institutions (presumably by a reserve fund and thus ultimately by higher tuition fees or reduced instructional expenditure, (d) the lender (presumably by a reserve fund collected by an interest premium and thus borne by all borrowers), or (e) a foundation or other source of philanthropy. If the government is the lender, there will be a default loss even if this loss is unrecorded and hidden in the shortfalls in future repayments.
7. *The ability of the loan scheme to tap the private capital market:* The ability to tap the private capital market, or *savers* generally, is a function of: (a) the anticipated revenue stream (which, in turn, is a function of the interest rate, or the degree of subsidization built in as a policy choice); and (b) the degree of risk, which is a function of the choice of target borrowers, the requirement for co-signatories, and the competence of the collection process. Loans with good repayment streams and low or moderate default risk are thereby mainly *assets*, the worth of which can be determined by the market, and the government or governmental agency that is the likely lender can capitalize or securitize its student loans and obtain new capital for new lending. To the degree to which the loans are highly subsidized and carry substantial risk of default, the loan notes carry little market value, cannot be easily capitalized or securitized, and must therefore be treated as mainly *expenditures*.
8. *The manageability of repayments.* Any loan scheme, of course, can be made manageable for almost any borrower with a sufficiently high degree of subsidization and a sufficiently long repayment period—but at very great cost to the government and to the loan recovery rate. The task for most student loan schemes is to balance manageability to the borrower and affordability to the government. Manageability of current (i.e. monthly) payments is easiest with an income contingent or a *hybrid* fixed schedule-income contingent form of repayment obligation, although these forms do not necessarily lower the total cost to most borrowers.
9. *Method of disbursement:* Whether the loans are to be disbursed directly to the students to pay for tuition fees or any other expenditure, or disbursed directly to the institution (i.e. never passing through the hands of the recipients), or not disbursed at all but merely held on the lender's (in most cases, the government's) books as a future receivable or possible future income surtax.
10. *Method of collection:* The two principal ways of collection are via monthly coupons, like most other forms of consumer debt, or via payroll deduction, in which the employer collects and remits the repayment after deducting it from the paycheck (along with other deductions for e.g. pension contribution, health insurance, or income tax withholding). Any form of repayment obligation can be collected by employers, but instances of seasonal or episodic employment, self-employment, multiple employers, or small businesses that may resist the additional paperwork and liability are all limits to the financial efficacy of student loan collections by employers.

³ *Generally-available* loans are loans that are not rationed or otherwise restricted to the credit worthiness of the student borrower or his or her parents.

11. *The form of the repayment obligation:* Finally, the loans scheme needs to stipulate the form of the repayment obligation: that is, whether a *conventional or fixed schedule* obligation (which, in turn, may be either in equal installments or in some other *shape*, such as rising over time in accord with anticipated growth in incomes), or an income contingent obligation, or a combination of the two, such as the *hybrid* variety.

The purpose of this exercise has been to reveal that in the context of these critical policy elements of a student loan scheme, the form of the repayment obligation—whether fixed schedule, income contingent, or hybrid—while it must be a part of the scheme, is simply not the overwhelmingly critical feature that its advocates frequently present it to be.

The Alleged Superiority of the Income Contingent Repayment Obligation

Proponents of income contingent loans frequently claim income contingent loans to be *ipso facto* superior to other forms of student lending. Two of the most commonly cited advantages of the income contingent form are: (1) that repayments are *easy* because they never exceed a certain percentage of income deemed to be *manageable*; and (2) collection costs and defaults are low because the required repayments are collected from the borrower's pay by the employer (Barr 2001, Chapman 2006a, and Chapman 2006b). However, in accord with our earlier observation of the tendency of income contingency to be oversold and sometimes to claim features that are not, in fact, unique to income contingency, let us examine first the claim that an income contingent repayment obligation is better, or easier, for the borrower.

Easier or better in reference to a loan repayment can refer to two quite separate attributes. The first is the total burden, or cost of the loan to the borrower, which can best be measured by the discounted present value of the stream of repayments, or the simple annual rate of interest. The total burden of a student loan is made *easier* only by governmental subsidization—and this applies to any form of repayment obligation, whether conventional or income contingent.

The monthly burden, or the ease of making the monthly payments, on the other hand, is quite different and can be made more manageable or more burdensome in a fixed-schedule repayment obligation simply by lengthening or shortening the repayment period. However, a long repayment period, while easing the borrower's monthly burden—particularly in reference to monthly salary—does little for the total burden, or ultimate cost of the loan. The monthly burden of a fixed schedule obligation in reference to monthly income can also be made more manageable for most borrowers by a repayment schedule that slopes upward over time (like most incomes), starting low and increasing monthly or annually. But again, neither feature affects the ultimate cost of the loan as measured by the discounted present value of the repayments.

Income contingent loan repayments, on the other hand, are manageable in their monthly burdens virtually by definition and can be made to be more so simply by lowering the percent of income that is required for annual or monthly repayment—although the effect, for most borrowers, will simply be to prolong the repayment period: that is, more manageable by the month, perhaps, but not any cheaper or easier in total burden. Of course, the borrower with a low lifetime income may come to the end of his or her repayment period having repaid the contractual percent of income or earnings, but

never enough to fully repay the loan at the contracted rate of interest. The repayment obligation may keep the low earning borrower repaying income contingently for some additional years. However, at some point, the income contingent loan scheme will forgive remaining debts. Such borrowers will then receive *effective grants* or subsidies, based not on the low income of their parents at the time they were students (as in conventional need-based grants or tuition fee discounts), but on the basis of their own low income over an effective earning lifetime.

For any given set of income contingent loan borrowers, the *generosity* of a particular income contingent loan scheme—that is, the likelihood of borrowers ever receiving a subsidy—as opposed to the mere convenience of extending the repayment period—depends on two elements of the particular income contingent scheme: (a) the percent of income or earnings owed each month, and (b) the total number of years that a low earning borrower must continue to attempt to repay the loan. A low percent of income or earnings will lead more borrowers to complete the initially calculated repayment period with a remaining debt; a short maximum repayment period will increase the proportion of these borrowers who will have their remaining debts cancelled: that is, actually receive a subsidy, or effective grant. And conversely, a high percent of income required for debt repayment plus a long period of time (beyond the originally estimated repayment period) to continue to try to repay the debt in full can be said to be *ungenerous*: Most of the borrowers will repay with full interest, and only the truly destitute borrowers will ever receive a genuine subsidy. In short, it is not so much the income contingent repayment obligation *per se* that makes this form of obligation more generous to the lifetime low earner as it is the policy decision to inject a high degree of subsidization—or conversely, to subsidize very little—into the parameters of the particular scheme. (The US income contingent loan, which is an option for many borrowers, does indeed smooth out the repayments in relation to monthly salaries but carries very little subsidization. Thus, the effect for most borrowers with low lifetime incomes is simply to greatly lengthen the repayment period, repaying more dollars of interest, but at the same real cost—or same *discounted present value*.)

The other advantageous feature frequently attributed to income contingency by proponents of that form of repayment obligation is that both defaults and administrative costs are lower because most income contingent loan schemes require employers to collect the required repayment at the point of wage or salary payment and remit them to the lender (generally the government). This may indeed be a positive feature, although there are claims and some evidence that income contingent repayment obligations, for some borrowers, may lessen the likelihood of declaring all income (such as second incomes) and thus jeopardize the larger goal of full voluntary income tax compliance, which is worth vast sums to governments that rely on income taxes.⁴ However, student loan collection by employers is generally a positive feature for the loan scheme—*but it has nothing to do with income contingency*. The government can compel employers to collect debts or obligations of any kind from their employees—say, local taxes, child support, or alimony—just as it has taken steps to compel employers to collect pension

⁴ See US Department of the Treasury and US Department of Education (1995) “A Study of the Feasibility of the IRS Collecting Repayments of Federal Direct Student Loans,” June 1995.

obligations (called *social security* in the United States), certain insurance contributions, and income taxes. Income contingent loan schemes usually have this as a feature (although the United States income contingent repayment option does not), but this feature can also be viewed as part of the general *packaging* of this particular form of student loan, which is to make it appear unlike a loan and without visible burden.

In addition, an income contingent loan presents some complications not found with conventional mortgage-type loans. Most of these arise from the need to stipulate precisely, and to be able then to verify, the income that is effectively to be “taxed” in order to arrive at the proper repayment amount. Multiple sources of income, highly variable income, income that tends to not get reported all, and income that can be easily shifted between a borrower and a non-borrower member of the family all constitute problems for the viability of an income contingent loan scheme. The highly industrialized countries of the European Union (EU) or the Organization for Economic Cooperation and Development (OECD), particularly those with a culture of voluntary income tax compliance, may be able to overcome these problems, as Australia, New Zealand, and the constituent countries of the United Kingdom seem to have done. For other countries, where sources of income or earnings are frequently multiple, highly variable, and generally unreported, the problem of establishing the repayment obligation will be a considerable problem and one that virtually invites misrepresentation of income and almost certain repayment shortfalls. (This is quite clearly the case in virtually all developing and transitional countries, but may also so the case in some European countries where income tax evasion seems to have been carried to a high art.)

The Need for Private Loan Capital

A relatively unexamined consequence of the choice of the form of the repayment obligation is the impact on the ability of a student loan scheme to tap the private capital market. In so far as one of the important aims of student loan schemes is to shift a portion of the costs of higher education from governments to students, the loans need ultimately to tap private savings rather than rely simply on revenue from governmental budgetary expenditures. Large-scale savings in industrialized countries are found mainly in commercial or investment banks and originate with corporate and insurance company reserves, funded pension plans, and the like, as well as with personal savings accounts. These private savings are tapped for student lending in three ways: (1) banks making, holding, and servicing the loans (generally with governmental and co-signatory guarantees); (2) universities or public student loan agencies originating the loans, but then selling the loan notes in “bundles” to the banks or other primary holders of savings; or (3) public student loan agencies making, holding, and servicing the loans (generally with governmental and co-signatory guarantees) but replenishing their capital by selling the notes of the agency itself to the private capital market, backed by the stream of guaranteed repayments of the loan notes, or *securitization* (Johnstone, D. B. and Marcucci, P. (2007).

Herein may lay another problem with loans of the income contingent variety. Unlike most conventional loans that may be defaulted upon but can then be collected from a guarantor or co-signatory (or collateral seized and sold), an income contingent loan, although fairly well insulated from defaults *per se*, can be recovering insufficient repayments due to the low but *misreported* current income of some borrowers that is not

detectable as a default or even an underpayment. The holders of the income contingent loan notes, then, may be less able to collect from the guarantor or co-signatory. Depending on the nature of the prevailing employment, the health of the economy, the technical ability of government to monitor all incomes, and the culture of compliance with income tax reporting and payment, the risk of under-payment on an income contingent loan may be nearly as common—but considerably more difficult to detect or to stem—as defaults and arrears on conventional loan repayments. Thus, loans of the income contingent variety may be less likely than conventional guaranteed loans to find private buyers—and thus be forced to continue their dependence on government expenditures for the loan capital itself in addition to the need for governmental subsidies and guarantees.⁵

The Expansion of Participation

One important aim of most student loan schemes is to allow students to assume more of the expenses of higher education, whether the costs of instruction via tuition fees or the expenses of student living, or maintenance. Another aim—to some degree working against the goal of shifting the expense burden from the government/taxpayer to the student—is to maintain, or even to enhance, *access to higher educational opportunities*. Taken by itself—that is, without any accompanying additional cost-sharing, or shift of cost burden to parents and/or students—the ability to borrow at a reasonable rate and with little or no collateral provides a way for some students, particularly those from poor families, or those who by any system or tradition have outgrown their financial dependence on their parents and who thus may have no other resources, to be able still to invest in their own higher education. In addition, a student loan scheme as a component of cost-sharing, designed to provide additional revenues to higher education, provides a way to expand revenues, therefore to expand capacity, and therefore to expand the participation of those for whom the access barrier is as likely to be insufficient higher educational capacity as it is to be insufficient personal or parental resources.

A question at that is responsive to the purpose of this paper, then, is whether a particular form of repayment obligation—specifically, a conventional fixed-schedule or an income contingent form—provides more access. Posed another way, this question asks whether one or another form of repayment obligation makes students more (or less) willing to go into debt in order to attend a college or university that he or she would have been unable to attend in the absence of the opportunity to borrow the necessary resources.

Loan scheme preference questions are exceedingly difficult to answer even in theory and are quite impossible to answer experimentally or through actual observation, as there have been so few occasions where there have been two different but fiscally comparable plans in operation long enough to see which one seems to make a difference in accessibility. In fact, the US Direct Loan Program provides the only generally-available student loan program in the world where borrowers have a choice between an income contingent, a conventional mortgage-type, and a fixed-but-graduated repayment mode—each with the same present value of anticipated repayments. In this contest, the

⁵ Even in Australia, where the Higher Education Contribution Scheme (HECS) seems to be a success and is a model for much of the world, the loans depend on government revenue, and the assets in the hands of the government (that is, *the promises to pay an income tax surcharge*) seem to have little market value.

income contingent option has not been the favored choice (US General Accounting Office 2001, pp. 82-92).

In fairness to the proponents of income contingency, the US income contingent option is also extremely complicated, notoriously ungenerous to low-earning borrowers, and lacks the convenience of being “piggybacked” onto the US income tax and social security withholding systems at the point of wage and salary payment, and so fails on all counts to provide the kind of loan that the proponents of income contingency have always advocated. The US income contingent option has been purposely constructed to maximize the recovery of repayments, minimize the need for governmental subsidization (at least beyond that called for by the conventional student loan plans), and not provide any further burden to employers or jeopardize the very high US voluntary income tax compliance. On the other hand, another reason for the relative lack of interest in the US income contingent repayment option may be that the US conventional student loan schemes currently provide such easy and almost automatic deferment in the event of a return to school as well as relief, or forbearance, and refinancing in the event of unemployment or other occasions of genuine financial hardship that the flexibility and manageability once thought to be the special property of income contingency seems now to have been built into US conventional loan programs as almost a *de facto* hybrid fixed schedule-income contingent loan scheme.

Income Contingent Loans and Political Expediency

Even if income contingent loans are neither *ipso facto* less costly or burdensome, than the more conventional counterpart, they may still be more politically saleable than loans of a conventional variety and thus, in the end, more likely to allow the introduction of cost sharing into a country where there is extraordinary resistance to the very concept of either students or parents bearing a significant portion of the costs of higher education. This is a purely political—almost a *public relations*—case for income contingency. The Australian Higher Education Contribution Scheme (HECS), for example, has been undeniably successful in expanding the revenue to higher education. It may also be said that it has done so by obscuring the fact that it is the *introduction of tuition fees*—less so the introduction of the particular means of handling the resulting student loan repayment obligation—that accounts for the increased flow of revenue to Australian public colleges and universities. The increased revenue still comes in the first instance entirely from the government. But the government is presumably more generous to the Australian universities because of the two forms of enhanced revenue offsets within HECS: (1) the increased non-governmental revenue from the parents who pay tuition up front to lessen their children’s HECS obligations, and (2) the increased governmental borrowing capacity that is, at least in theory, partly covered by the government’s new assets in the forms of the signed HECS future *surtax* obligations. Similarly, in the case of Scotland in 1998 and the rest of the United Kingdom beginning in 2006, most students and most of the political left—virtually all of whom had been unalterably opposed to the 1997 introduction of tuition fees throughout the UK—seem to have accepted the conversion of the relatively modest, means-tested, up-front tuition fee borne mainly by middle and upper-middle income parents to an entirely student-borne income contingent loan, evidently preferring the additional burden on students to Britain’s politically unpopular

tuition fee. (In 2007, the Scottish government took an additional step toward undoing cost-sharing by removing even the deferred tuition fee.)

Some academics and policy analysts may be made uncomfortable by what might be viewed as *misrepresentation*; for example, by calling a mandatory contribution from students and/or parents to cover a portion of instructional costs anything but what it is: *a tuition fee*. Furthermore, students who are made to believe that their income contingent obligations are fundamentally unlike real debts may borrow more than they need to, or even mean to. Similarly, politicians may erroneously believe (or be allowed to pretend that they believe) that they have solved a serious higher education revenue problem when of course they have not—to the fiscal jeopardy of the public universities and possibly as well to the students. On the other hand, if the ideological and political opposition to tuition fees and other elements of cost-sharing is so extreme—and the need for other-than-governmental revenues is so great—then perhaps the introduction of tuition fees and student loans under the cover of an *income contingent contribution* is worth the price of just a little misrepresentation.

In summary, income contingent loans modeled after the Australian Higher Education Contribution Scheme (HECS) and spread more recently to the constituent countries of the United Kingdom, would seem to work well when:

- A government, by downplaying (or not mentioning at all) the politically treacherous concept of *tuition fees* is able to get an element of cost sharing that it would likely be politically unable to get were it to advocate openly even a modest tuition fee.
- A government, in stressing mainly the income contingent loan obligation of the student *in lieu of a tuition fee*, is willing to forego the potential of more *up front* tuition and to minimize the role of parents (even affluent ones) as an important partner in sharing the costs of higher education.
- A government does not need the students' deferred revenue *now*, but is able to tax and/or borrow sufficiently to keep the public universities academically strong and accessible, and is willing and able to be the true lender for the student loan scheme.
- The majority of student borrowers (or students who become obligated to future income contingent payments) will have during most years of their working lives a single employer at a time, which will pay them a periodic and relatively regular salary, and which will also be sufficiently large, sophisticated, and legally compliant that it can be counted upon to take out of the borrower's paycheck the correct amount owed for student loan repayment, year in and year out.

Conversely, HECS-type income contingent loans are less applicable when:

- The need is for non-governmental revenue *now*, making the parental contribution to tuition (even with a great deal of discounting) the primary source of needed revenue supplementation.

- The scarcity of governmental revenue precludes government from being the sole lender (which places a premium on student loans that have some value on the private capital market, however discounted).
- Many of the graduates (borrowers) are likely to hold multiple short-term jobs and to be employed in the informal economic sector, where records are most unreliable, or to emigrate.
- There is no tradition of voluntary, reliable self-reporting of incomes, and the state systems for monitoring and verifying incomes for the purpose of income tax withholding and/or pension or social security contributions are non-existent or unreliable.

Summary

Cost-sharing, or the shifting of increasing portions of the costs of higher education from governments and taxpayers to parents and students early in the 21st century is expanding even as it remains politically and ideologically controversial. Within this policy shift, student loans, also controversial, seem destined to play an increasingly important role. Sometimes the role of student loans is to partly disguise the introduction of tuition fees. But student loans can also cushion their impact as well as provide a seemingly more cost-effective form of financial assistance for the inevitably increasing costs of food and lodging as well as increasing tuition fees.

Of the several forms of student loan schemes, the income contingent form of deferred tuition fees employed by Australia in its Higher Education Contribution Scheme and the income contingent form of deferred tuition fees employed in the UK, first by Scotland (and more recently abandoned) and then by England and Wales, are receiving increasing attention from politicians and policy makers around the world who are seeking student loan schemes that are fiscally affordable and politically feasible, and that accommodate the twin goals of expanding revenue for higher education while also expanding student access and participation.

While the Australian scheme appears to have been financially successful for its incorporation of new tuition fees as well as politically and socially successful for its incorporation of a student loan that has expanded access and participation (Chapman 2002), it is not entirely clear how much of this success is attributable to the *income contingent* feature of repayment obligation (as opposed to beneficial features that can be incorporated in other forms of repayment obligation), nor is it yet clear whether the income contingent form of repayment obligation can be financially successful in other countries.

Student loan schemes are important, both to the financial viability of higher educational institutions and to the accessibility of these institutions to students without regard to the income or other background characteristics of their families. But student loans are also more complicated than often portrayed and for that reason are easily accompanied misunderstanding, misrepresentation, and unintended consequences. Countries contemplating the adoption of loans, or of financial schemes that incorporate the deferment of a student contribution, should study carefully both the theoretical

underpinnings of cost sharing and the actual operations of alternative programs of tuition fees and student loans.

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8/19/08