Financing Tertiary Education

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Upgrading Human Capital and Skills Development for Future Asia
Crawford School
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Outline

Background: The need for university expansion in Asia; thus the critical role of financing

1. Is there a case for university tuition charges?
2. Why are student loans necessary?
3. The major difference between TBRLs and ICLs: Repayment
4. The effects of TBRL and ICL
5. Repayment burdens
6. Defaults
7. TBRLs and ICLs: Family formation and job choice
8. Images of Loan Systems
9. The critical role of administration for ICL
10. Conclusion
1 Is there a case for charging university tuition?

(i) Everything has to be paid for: what does “free” higher education actually mean?

(ii) Private rates of return to higher education are high: see age-earnings profiles

(iii) Additional money can be used to grow the system (e.g. Australia and the UK)

(iv) Not charging tuition fee is regressive and inequitable (see Karl Marx)
Age-Earnings Profiles: Vietnam

**Females**

<table>
<thead>
<tr>
<th>Age</th>
<th>Real monthly earnings ('000 VND)</th>
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<tbody>
<tr>
<td>22</td>
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<tr>
<td>27</td>
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- High school
- Bachelor degree

**Males**

<table>
<thead>
<tr>
<th>Age</th>
<th>Real monthly earnings ('000 VND)</th>
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</thead>
<tbody>
<tr>
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</table>

- High school
- Bachelor degree
Age-Earnings Profiles: Korea

Females

Males

Annual after-tax income (10,000 KRW)

Age

- High school
- Tertiary degree

- High school
- Tertiary degree
Age-Earnings Profiles: Brazil

**Females**
- Female tertiary
- Female secondary

**Males**
- Male tertiary
- Male secondary
Age-Earnings Profiles: England

Females

Males

- HE Graduate
- High School Graduate
“If … higher education institutions are also “free”, that only means in fact defraying the cost of education of the bourgeoisie from the general tax receipts.”

Karl Marx, *Critique of the Gotha Program*, 1875
Why are Student Loans Necessary?

i. Risky investments: non-graduation, poor jobs

ii. Poor education/employment outcomes for students/graduates can lead to default

iii. With no saleable collateral, banks/governments are unprotected

iv. Two types of loans:

*Time-Based Repayment Loans (TBRL):* US, Canada, Colombia, China, Japan, Brazil

*Income-Contingent Loans (ICL):* Australia, New Zealand, England, Hungary, Korea
3 The Major Difference between TBRLs and ICLs: Repayment rules

i. **TBRLs** have repayment obligations fixed over time

ii. Explaining the US TBRL: requires all repayments in 10 years

iii. **ICLs** have no repayment obligations unless the debtor’s income is high

iv. Explaining the Australian ICL
4 (i) The Effects of TBRL

Because capacity to pay is ignored, TBRLs can mean:

- Repayment hardship and anxiety
- Borrowing from loan sharks, or friends and family
- Defaults
- Low government revenue from deferment or default
- High collection inefficiencies and costs from governments chasing loans
REMBoursez Votre prêt d'études du Canada

Pour éviter d'être en défaut de paiement, communiquez avec votre banque :
- au début de chaque année scolaire ;
- à la fin de vos études ;
- si vous déménagez ;
- si vous abandonnez vos études ;
- si vous devenez étudiant à temps partiel.

SINON VOICI LES CONSÉquences :
- votre réputation de solvabilité sera ternie ;
- vous n’auriez plus droit à des prêts d'études ;
- vous feriez l’objet de mesures de recouvrement ;
- vos remboursements d’impôt seront retenus.

REMINDER

Repay your Canada Student Loan

To avoid defaulting, keep in touch with your bank:
- when you begin a new school year;
- at the end of your studies;
- if you move;
- if you drop out;
- if you become a part-time student.

Consequences if you don’t:
- poor credit rating;
- no further Canada Student Loans;
- collection action;
- withholding of income tax refunds.
4 (ii) The Effects of ICL

Because ICLs have no repayment obligations when incomes are low:
- No repayment when unemployed
- No repayment when in low paying jobs
- No repayment if not in the labour force rearing a child

Therefore:
- No repayment hardships
- No struggle or anxiety
- No default and credit reputation loss
- No loss of future government revenue from default

Also:
- Highly efficient if collected by employers
- No need for a large and expensive government administration
5 The Critical Role of Repayment Burdens in TBRLs

\[ Repayment\ burden_t = \frac{Loan\ repayment_t}{Income_t} \]

- High RBs lead to hardship, anxiety borrowing from loan sharks and defaults

- Simply, TBRLs can’t be repaid by many debtors without help from others (job choice and family formation issues must be affected)

- How high can RBs be?
International comparison of RBs with TBRLs

Repayment Burdens for Poorest 20 percent of Male Graduates

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent</th>
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<tbody>
<tr>
<td>China</td>
<td>30.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>53.7</td>
</tr>
<tr>
<td>Colombia</td>
<td>&gt;100.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>43.0</td>
</tr>
<tr>
<td>South Korea</td>
<td>&gt;100.0</td>
</tr>
<tr>
<td>Japan</td>
<td>33.1</td>
</tr>
<tr>
<td>USA</td>
<td>43.0</td>
</tr>
</tbody>
</table>
International comparison of RBs with ICLs (max percent of income)

- Australia: 8
- NZ: 10
- England: 9
- Hungary: 6

Thus, RB risks for borrowers are a zero concern for ICLs!
6 Defaults: International experience of defaults with TBRL (per cent)

TBRLs

- Brazil: >30
- Canada: 15
- Colombia: 35-50
- Malaysia: 35-50
- Thailand: 45-70
- US: 25-35

Default risks for borrowers is a major concern

ICLs

- Australia: 0
- England: 0
- New Zealand: 0

Default risks for borrowers a zero concern
7 TBRLs and ICLs: Family formation and job choice

(i) Major parts of TBRLs are being paid by family members so this must influence marriage and fertility decisions

(ii) TBRL and occupational choice: the case of US lawyers

(iii) Thus TBRLs are inefficient and distortionary from the perspective of economic choices

(iv) All avoided with ICLs
8 Images of TBRLs and ICLs:

The monster, the crocodile, and the kitten
TBRLs
9 The critical role of ICL administration

i. All countries are different: administrative issues are critical

ii. The informal sector needs to be understood

iii. Employer with-holding needs to work

For ICL: For the student/graduate debtor:

- no administration issues
- all automatic, no applications needed
- accurately reflects current circumstances
- zero default recording
10 Conclusion

i. There is a strong case for tuition

ii. Student loans are necessary

iii. The two loan options differ radically: collection is everything

iv. For borrowers TBRLs incur difficult repayments burdens, important default costs and are administratively expensive

v. For borrowers ICLs provide insurance against repayment difficulties and default

vi. For governments ICL likely maximise revenue

vii. Administration/collection issues are critical for policy