Making Student Loans Work In the Caribbean States

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Making Student Loans Work: Options and Issues

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Beginning Assumptions:

1. Demand for higher education throughout the Caribbean will increase: (demographics, economy, personal aspirations)
2. The revenue needs of higher education will increase even faster: <u>Inflation++</u>
3. Revenue needs will increase faster than likely increases in available public taxes (competition)
4. Therefore, most countries will experience an increasing need for <u>other-than-tax revenue</u>

Possible sources of supplemental (other than tax) revenue

- Entrepreneurship (sales of faculty & university services – but brings added costs)
- Philanthropy (difficult and uneven at best)
- Discovery of massive amounts of oil [?]
- Shifting more of the increasing cost burden to families or students: <u>cost sharing</u>

Cost-sharing:
Is both fact and Worldwide trend

- Begin or sharply increase tuition fees <u>for all</u>
- Begin / sharply increase tuition fees <u>just for some</u>
- Begin or increase fees for lodging & food
- Diminish or freeze stipends & other subsidies
- If there are to be loans, increase rate of interest (diminish the effective grant subsidy)
- If there are to be loans, improve collection
- Allow & encourage expanded private sector

The Critical Balance for a Cost-Sharing Policy

1. The need for revenue:
   - To preserve quality
   - To accommodate expanding enrollments
2. The Maintenance or advancement of access
   - Lessen inter-generational transmission of status, wealth, and power

- Recognize that students on enrollment margin have great financial need

The Access / Equity Goal Requires:

- ✓ Fees and fee increases to be modest
- ✓ Appropriate recognition of parental responsibility
- ✓ Non-repayable grants / bursaries for neediest
- ✓ Cost effective means-testing
- ✓ Generally available student loans
- ✓ Policies to limit unmanageable debt burdens
- ➢ <u>Improvement of academic preparedness & aspirations at middle and secondary levels of education</u>

Student Loans: The Bad News

- The record of student loans – in terms of providing a robust other-than-governmental stream of revenue, <u>net of all the tax-supported expenses of agency administration, interest rate subsidization, and coverage of default</u>s - is not at all good.
- In fact, some programs would save governmental money if converted to outright grants

The Encouraging News

- Student loans <u>can</u> work: to provide more student access to tertiary education per tax dollar than low or no tuition fees for all or than non-repayable grants or bursaries
- The failure of student loans schemes is predictable and largely avoidable.
- The main problem is well-meaning but misguided government policies that advocate:

The predictable problems of student loan schemes [5]

1. Interest rates too low (excessive subsidization)
2. Too many loans given: thus most <u>too small</u> to make a difference (an unwillingness to <u>ration</u>)
3. Loan programs begun with insufficient staff, professionalism, and time to prepare the administrative and legal bases for collection
4. Loans given without impressing on students the need to repay & the consequences of default

predictable problems continued

5. Loans that do not tap the private capital market and thus are given entirely from governmental operating budgets, competing with all other governmental expenditures, and never treated as assets on the government's books and thus able to be sold or securitized.

- But most failures are predictable and avoidable.

Principles for the Establishment of Successful Student Loan Schemes

- First: clarify the mix of purpose: (1) simply putting money in hands of students, and (2) seeking a robust other-than-governmental stream or streams of revenue, net of all the tax-supported expenses of agency administration, interest subsidization, and coverage of defaults.
  - #2 is not popular – but is absolutely essential due to the inability of governmental revenue to keep up with the annually surging costs / revenue needs

Principles continued

- Second: The discounted present value of the supplemental revenue (the value of loans as assets) depends on:

1. The interest rate (need to minimize interest subsidies)
2. The recovery rate (must minimize defaults)
3. The Administrative costs of servicing and collecting (need for efficiency & cost-effectiveness)

Principles

- <u>Third</u>: Within the purpose of seeking supplemental revenues, clarify the additional policy goals:
  - ✓ Maximizing access;
  - ✓ Rewarding academic achievement;
  - ✓ Enabling living away from home;
  - ✓ Enabling financial independence from parents;
  - ✓ Enabling choice of private institutions
  - ✓ Encouraging choice of selected programs
  - ✓ Influencing post-completion occupation / venue

Principles continued

- <u>Fourth</u>: Politicians must realize that student loan schemes will not relieve government of a need to:
  - ✓ Continue (and increase) annual operating budget support for all public colleges & universities; and
  - ✓ Continue (and increase) annual tax contributions into the student loan scheme: no such thing as a generally available s<u>elf-sustaining</u> student loan program.
  - ✓ Loans can provide more access per dollar than grants. But (1) <u>not that much</u>, and (2) <u>only if done properly</u>.)

Principles continued

- <u>Fifth</u>: The solution to the underlying austerity of higher education must not be seen as being solved entirely "on the backs of" students. Thus …
  - ✓ Universities must be seen as trimming costs.
  - ✓ Governments (politicians) must be seen as more efficient (and less corruptible).
  - ✓ Students must get something such as:
    - ✓ Better quality,
    - ✓ More accessibility (greater capacity)
    - ✓ More choices (of residence, institution, independence)

The three legs of the stool of successful student loan schemes:

1. Design: building in minimal interest subsidization and real theoretical recovery.
2. Executi**on**: minimizing non-repayments / defaults.
3. Tapping private capital: lessening the annual demands on Governments operating budget and treating students loans as real assets rather than as expenditures.

Summary

1. Student Loans are essential to Cost-Sharing
2. Student Loan Schemes can "work" financially: that is contribute to net revenue
3. But student loan schemes that are generally available are always costly at best … need annual & increasing new government revenues … and can never be "revolving."
4. Student loan schemes can contribute to access and well-being: students should be supportive

5. Loan schemes require <u>extensive</u> planning:

- √ legal form of lender and loan servicer (e.g. banks, a government agency, a public corporation, private contractors);
- √ Selection of leaders (political or board appointee);
- √ Selection of staff (professional or civil service);
- √ Legal provisions (e.g. wage attachment, co-signatory obligations, access to tax records);
- √ Limits on availability (e.g. private, or out-of-country)

6. Terms and conditions must be set—e.g.:

a. Who is to be eligible to borrow how much per year and how much in aggregate?

b. Available to students at private or short cycle colleges?

c. Severity of means-testing?

d. Other forms of rationing (e.g. program, academic merit)?

e. Form of repayment obligation (fixed or income related)?

f. Interest rate?

g. Repayment period?

h. Provision for economic hardship?

7. Defaults must be minimized:

- ✓ Begin at <u>origination</u> and <u>extend through in-school years,</u>
- ✓ Be clear about obligation; avoid euphemisms & obfuscations; require exit interviews,
- ✓ Consider co-signatories (soft & hard),
- ✓ Need competent professional servicing (electronic records capability, legal recourse of lender),
- ✓ Collection by <u>employer</u> good for <u>some</u> debts, but will still need “regular” monthly collection capability
- ✓ Schemes can be introduced in stages, beginning with the least risky (e.g. medical & other advanced professional)

Final observations continued:

8) Protection against unmanageable debt burdens is important -- options:

- ✓ <u>Income contingent</u> repayment obligations: not *cheaper* for all students or *better* for all schemes (difficult to collect or to securitize)
- ✓ <u>Hybrid</u> schemes: repay fixed amount or % of income, whichever least – generosity varies by policy
- ✓ Student loan schemes can be introduced in stages, beginning with the least risky

Finally, political realities of cost-sharing

1. There will be political opposition.
2. The financial benefits to the state are real but limited.
3. The financial benefits to students are also real, but will still be opposed by association with (opposition to) tuition fees.
4. Students must get (1) better quality, (2) more access, or (3) both.

~ The End ~