5 Higher education financing and inequality

The critical role of student loan scheme design – illustrations from Indonesia, Vietnam and Thailand

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INTRODUCTION

Many Asian countries in recent decades have experienced relatively rapid economic growth and significantly expanded enrolments in, and graduations from, higher education. This is no coincidence: higher education is both a contributor to, and is caused by, economic growth. As economies become richer and more sophisticated, employers' demand for highly skilled labour expands and, concomitantly, there is an associated increase in the supply of young, prospective higher education participants. Formal education is a critical determinant of the general economic welfare of individuals, so expanded supplies of highly educated people inevitably affect income inequality.

Two crucial roles for government in these processes seem to be incontestable: one, to provide appropriate funding mechanisms and assistance to ensure that required levels of higher education expansion are met; and two, to design public policies related to this goal in such a way as to increase rather than decrease the participation in higher education of the relatively disadvantaged.

This paper relates to both roles, and examines the critical higher education policy issue of student loans. It is explained that government intervention in the form of student loans is a necessary aspect of higher education, on both efficiency and equity grounds. Given the well-recognized failure of capital markets to assist in the financing of these investments (Friedman 1955), governments of nearly all countries provide various forms of intervention and subsidies to both help reduce inequalities in access to higher education and to ensure that there are sufficient higher education graduates to underwrite economic growth.

Many countries use financial assistance instruments such as means-tested grants and student loans, with the latter type of intervention taking two broad forms: government guaranteed mortgage-type loans (often provided by commercial banks) and income contingent loans (ICLs) (Chapman 2006). There is a considerable literature[2] analyzing student loan policies, with a recent and key contribution focusing on the difficulties debtors might

face in the repayment of their loans. So-called repayment burdens (loan repayments as a proportion of future lifetime and age-specific incomes) (RBs) are an extremely important design aspect of loans, and expectations of their level have the strong potential to influence both the take-up of loans and the default risks for potential students.

In this chapter, for the first time, estimates are presented of expected RBs for mortgage-type student loans schemes for both Indonesia and Vietnam, and this is done in a comparative context with RBs calculated for Thailand. Critically, and following the methods designed and developed in Chapman and Lounkaew (2010a, b) and Chapman *et al.* (2010), and being further developed in Chapman and Liu (unpublished)[3] and Chapman and Suryadarma (unpublished)[4], the exercises have been undertaken with the use of unconditional quantile regression modelling with respect to income determination, which has the major advantage of illustrating the difficulties to be faced by student debtors who experience low graduate incomes in the future.

It is revealed that RBs are likely to be high for a significant minority of graduates in all three countries, but that for prospective students in Indonesia and Vietnam the repayment difficulties are revealed to be so problematic that the traditional mortgage-type student loan approaches to financing higher education in these countries are likely to prove to be unworkable. A different student financing method is needed; and how it might work and the associated administrative difficulties are explained briefly in the conclusion.

UNDERSTANDING THE ROLE OF GOVERNMENT AND STUDENT LOAN SCHEMES IN HIGHER EDUCATION FINANCING POLICY

The need for student loans

A significant financing issue for higher education discussed above is that there is a case for both a contribution from students and a taxpayer subsidy. The next important question is: is there a role for government beyond the provision of the subsidy?

An understanding of the issue is facilitated through consideration of what would happen if there were no higher education financing assistance involving the public sector. That is, a government, convinced that there should be a subsidy, could simply provide the appropriate level of taxpayer support to higher education institutions, and then leave market mechanisms to take their course. Presumably this would result in the institutions charging students up-front on enrolment for the service.

However, there are major problems with this arrangement, traceable in most instances to the potent presence of risk and uncertainty. This critical point was first raised by Friedman (1955). The argument can be best understood with reference to the nexus between labour markets and human