



Income-Contingent
Student Loan
Repayment Systems
Outside the U.S.

By



NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

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Paper Description

This paper accompanies *Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk*, a paper by a consortium of five student-aid advocacy and research organizations – HCM Strategists, the Institute for Higher Education Policy (IHEP), the National Association of Student Financial Aid Administrators (NASFAA), New America (NA), and Young Invincibles (YI) – that proposes automatically enrolling federal student loan borrowers in a single repayment plan based on income (“auto-IBR”). The proposals in this paper are intended to complement proposals in the consortium’s paper. However, the proposals in this paper reflect the recommendations of NASFAA and are not supported by all groups in the consortium. Financial support for this research was provided by a grant from the Bill & Melinda Gates Foundation through the Reimagining Aid Design and Delivery (RADD) project.

Glossary

- **Auto-IBR** – refers to the consortium’s proposed single, auto-matic repayment plan based on income for all new federal student loan borrowers.

There is remarkable diversity in student loan systems throughout the world. In considering the ideal approach to system of loan repayment based on income here in the United States, it is valuable to examine the nature, successes, and failures of some other countries' methods of offering borrowers income-contingent student loan repayment. Two countries that seem to be particularly relevant to the efforts of this consortium are Australia and the Netherlands. While far from the only countries that use an income-contingent student loan repayment scheme, these two were selected for analysis because of the differences they illustrate: a "pure" system in the case of Australia and a "hybrid" system in the case of the Netherlands.

Australia

Before looking at the specific mechanics of the Australian student loan system, it is critical to understand a philosophical difference between their system and that of the United States. The U.S. system assumes that parents of dependent students bear the primary responsibility for college costs, and that they should pay these costs up-front. In contrast, Australia looks to the students themselves to take responsibility for the cost of their education, so their system defers these costs until after graduation.¹ These two philosophies are not mutually exclusive; certainly many students and parents in the United States defer up-front costs via a loan, and likewise some students and parents in Australia pay up front to reduce the ultimate costs that deferring would entail. In general, however, it is helpful to understand the philosophical differences at the foundation of each country's system.

It is also important to remember that for almost twenty years Australia effectively offered free higher education, having abolished university fees between 1970 and 1989. Since 1989, and particularly in recent years, they have moved away from a no-tuition model, implementing an income-contingent repayment system as a way to shift some of the cost of higher education from the government to students. Historically, U.S. students and families have paid substantial portions of their postsecondary expenses both upfront and through loans. In considering modifications to the U.S. student loan system to improve the overall repayment rate, it is valuable to understand Australia's shift to an income-contingent repayment scheme.

Australia established its Higher Education Contribution Scheme (HECS) in 1989 with the goal of placing students in a position of greater responsibility for assuming college costs. While students may choose to pay up front in exchange for a discount on their tuition (10 percent of any payment larger than A\$500), many students elect to borrow an HECS Higher Education Loan Programme (HELP) loan to cover their costs. These loans are available to students attending through a "Commonwealth supported place," which is the term for subsidized enrollment at a university.² Eligibility for a Commonwealth supported place is based simply on citizenship, residency, and enrollment. However, being eligible

doesn't necessarily ensure receipt of a Commonwealth supported place, as institutions make their determination based on some measure of merit and entry standards.³ Roughly forty institutions⁴ offer Commonwealth supported places, the overwhelming majority of which are public institutions. As of 2011, 90 percent of students in Australia attended a public institution.⁵

Domestic students who study at an approved private higher education provider can be offered either a Commonwealth supported place or a fee-paying place. A Commonwealth supported place is substantially subsidized by the Australian government, so students are required to pay only "student contribution" amounts for their units of study. The student contribution amount (Fig. 1) is calculated using the Equivalent Full-time Student Load (EFTSL), which is a multiplier tied to a student's year in school, discipline of study, and level of enrollment.⁶

Prior to 2005, the Australian government set the level of tuition and fees at all schools. Subsequently, that process has been deregulated and schools have the authority to set their own fee levels; however, the government still establishes the maximum it will pay for a student receiving a Commonwealth supported place. The government establishes the level of subsidy based on a combination of the market value and national interest in a specific program of study.

Fig. 1: Student Contribution Amounts for 2013

| Student Contribution Band | Amount per EFTSL |
|--|-----------------------|
| Band #1: humanities, behavioral science, social studies, clinical psychology, foreign languages, visual and performing arts, education and nursing | A\$5,868 (US \$5,249) |
| Band #2: mathematics, statistics, computing, built environment, other health, allied health, science, engineering, surveying, agriculture | A\$8,363 (US \$7,481) |
| Band #3: accounting, administration, economics, commerce, law, dentistry, medicine, veterinary science | A\$9,792 (US \$8,759) |

Source: https://studyat.anu.edu.au/2013/fees_and_charges.html

Students needing assistance to pay cost of living expenses may be eligible for a government grant or they can turn to the private loan market. However, the government does not offer loans for cost of living expenses beyond a very nominal amount of additional borrowing permitted for paying amenities fees, currently capped at A\$263.

Once in repayment, Commonwealth-supported students make payments at rates ranging from 4 to 8 percent of their total income after they pass an annual income threshold of A\$51,309 (US \$48,000) (Fig. 2). For comparison, the median wage for a full-time worker in Australia in 2011 was A\$57,400.⁷ The Australian system collects loan payments via a

mix of employer withholding and year-end tax payments. The system does not contain forgiveness provisions for age or length of time since the loan was borrowed, but it does offer forgiveness if a borrower dies. Borrowers can make voluntary payments in addition to the compulsory payments through income withholding. Voluntary repayments of A\$500 or more receive a bonus equal to 5 percent of the voluntary payment amount. At the end of 2013, pending legislation⁸ designed to reduce government spending proposed removing this benefit as well as the 10 percent bonus for up-front payment of tuition. However, both benefits continue for the time being.

Fig. 2: Income Thresholds and Repayment Rates (2013-14)

| Income (A\$) | Percent of Income | Income (A\$) | Percent of Income |
|-------------------|-------------------|-------------------|-------------------|
| Below \$51,309 | 0.0% | \$71,278-\$77,194 | 6.0% |
| \$51,309-\$57,153 | 4.0% | \$77,195-\$81,256 | 6.5% |
| \$57,154-\$62,997 | 4.5% | \$81,257-\$89,421 | 7.0% |
| \$62,998-\$66,308 | 5.0% | \$89,422-\$95,287 | 7.5% |
| \$66,309-\$71,277 | 5.5% | Above \$95,288 | 8.0% |

Source: <http://studyassist.gov.au/sites/studyassist/payingbackmyloan/loan-repayment/pages/loan-repayment>.

Interestingly, Australia adjusts the student’s accumulated debt annually to reflect changes in the cost of living as measured by the Consumer Price Index (CPI). This allows the debt to maintain real value and means that the debt carries a real rate of interest of zero.⁹ That does not mean that these loans do not have an effective interest rate, however. After factoring in the “pay upfront” discount, students who choose to borrow essentially end up paying interest on their college costs when that difference is amortized over the lifetime of the repayment.¹⁰

Australia offers a parallel loan program called FEE-HELP for students not receiving a Commonwealth supported place. While this program similarly collects payments based on income and links debt accrual to the CPI, it carries an additional 25 percent fee for undergraduate study, charged at the time of each disbursement. The lifetime limits (Fig.3) in FEE-HELP vary based on course of study; the fee does not count towards these limits.

Fig. 3: Lifetime Limits in the FEE-HELP Program

| Program of Study | Lifetime Limits in 2013 |
|---------------------------------|---------------------------|
| Medicine, dentistry, veterinary | A\$116,507 (US \$107,687) |
| All other programs | A\$93,204 (US \$86,148) |

Source: <http://studyassist.gov.au/sites/studyassist/helppayingmyfees/fee-help/#HowMuchCanIBorrow>

One in eighteen of all Australians¹¹ —approximately 900,000 domestic students¹² — are enrolled in higher education. Currently, one in fifteen Australians has student loan debt,¹³ the average student loan debt is approximately \$15,000, and the total amount of outstanding HELP debt as of June 2011 is estimated to have a market value of \$23 billion (\$15.5 billion using a fair-value accounting method).¹⁴ For comparison, about one in eighteen¹⁵ of all Americans is enrolled in higher education with an average loan debt of approximately \$23,053.¹⁶

Discussion

Referring to HESC as a “loan” allows the Australian government introduce cost-sharing without the attendant political fight that would occur if they simply described it as deferred tuition. The term “loan” gives students greater ownership and responsibility for their own education, and underscores the notion of higher education as an investment. Some view government subsidy of student aid as regressive because people who benefit from a college education tend to have higher earnings.¹⁷ This system addresses that claim by partially shifting the costs onto students who gain higher earnings after college.

Students can defer their payments without incurring interest above inflation until their incomes reach a certain threshold. This has the effect of sheltering students from the vagaries of a post-graduation job market or allows them to pursue lower-paying, but perhaps socially conscious, employment.

By presupposing that the funding burden falls to the students and making them aware of their aggregate lifetime borrowing limit, the Australian system allows students to know in advance how much access they will have to education loan financing. This is not necessarily true in the United States where students might know their lifetime federal student loan limits, but may find it difficult to calculate the dollar amount of their family’s eligibility for PLUS or private loans, which is based on institutional cost of attendance and loan qualification.

Researchers frequently cite the front-end simplicity of the Australian as a positive feature; however, that is tempered slightly by the complexity the different income bands during repayment.

The Australian system is designed to essentially eliminate defaults by integrating repayment fully into their taxation authority. However, an obvious drawback to the system is the difficulty of collecting payments from borrowers who leave Australia after graduation. Since repayment is collected through the tax system and employer withholding, students who do not remain in Australia may not repay their loans. Some studies have suggested that non-payment of loans due to expatriation or lack of income might be as high as 20 percent.¹⁸ The issue of full cohort repayment of loans was recently highlighted that \$6

billion of the \$25 billion in outstanding HECS debt is likely never to be repaid.¹⁹ Higher education researcher Alex Usher suggests that this is largely a result of setting repayment thresholds too high. The program design exempts a very large portion of a borrower's income such that a borrower earning a moderate income may never repay.

Some scholars have cited the cost of the subsidy as an additional drawback. With the loans capped at inflation while the government typically borrows at a rate 2-3 percent points higher, the estimated total cost to the government is around \$600 million a year.²⁰

Another possible shortcoming to the Australian system is that it does not target any particular subset of students for higher education subsidies. Ultimately, students receiving the largest subsidy will be those choosing the most expensive program of study, those who stay in school the longest, or those who experience prolonged periods of low or even moderate income after graduation.²¹ This runs counter to current efforts in U.S. higher education policy to encourage on-time degree completion and target aid toward needy students (although one could make a counter-argument that a large portion of U.S. federal student loans are neither subsidized nor targeted at needy students).

Indeed, one might argue that the Australian system is a shift away from publicly funded higher education and that it diminishes the concept of post-secondary education as a public good in favor of privatization that places the financial burden on the student. While some may view this as a positive feature, others would certainly argue the opposite.

An area that might warrant additional research is whether the Australian system, with its philosophy of student responsibility and its approach to deferred payment, may have a negative effect on college-saving behavior.

The Netherlands

On the surface, the Netherlands uses a system of higher education financing that bears little resemblance to those of either the United States or Australia. Effectively, all full-time students are provided with a loan (the 2013 interest rate is .6 percent) to cover the cost of tuition. However, this loan converts to a grant for students who achieve certain academic benchmarks. Since the inception of the program, the primary academic requirement has been for a student to graduate within 10 years of starting classes. (The first-time college graduation rate in the Netherlands was 41.4 percent in 2008, compared to 37.4 percent for the U.S.²²). To be eligible for the program to cover living expenses in addition to tuition, students must work a certain number of hours (currently 56 hours) per month.

The Netherlands makes additional means-tested conditional loans (i.e., loans awarded based on financial need that can be converted to grants) available to some students to cover expected parental contributions. Finally, it makes true loans (i.e., no conversion to

grant) available to students who do not meet the means-tested eligibility. Students borrow on a monthly basis throughout their course of study, and subject to the limits of each grant/loan, borrowers may increase or decrease their requested amount each month (Fig. 4).

Despite these marked differences, one way that the Netherlands is similar to the United States is that payment is expected up front and therefore is largely assumed to be a parent responsibility. The government does not explicitly subsidize the loans, but the interest rate is below-market and equal to the government cost of borrowing.²³

The government sets the annual tuition rate, which is €1,835 for most courses for the 2013-14 school year.²⁴ Private universities may establish higher levels of tuition and fees.

Fig. 4: Award Amounts in the Netherlands (2014)

| Name | Amount Living Away (monthly) | Amount Living with Parents (monthly) | Means-Testing |
|------------------------------|------------------------------|--------------------------------------|-----------------|
| Basic grant/loan | €279 (US \$384) | €100 (US \$138) | None |
| Supplemental grant/loan | €258 (US \$355) | €237 (US \$326) | Parental Income |
| Cost of living loan | €295 (US \$406) | €295 (US \$406) | None |
| Additional tuition/fees loan | €153 (US \$211) | €153 (US \$211) | None |

Source: <http://www.ib-groep.nl/particulieren/international-student/student-finance/payment.asp>

Students receive a two-year grace period on all student loans after graduation or cessation of studies.²⁵ Once in repayment, the monthly repayment amount is calculated as an annuity to be paid back in full over 15 years. Debt remaining after 15 years of repayment is forgiven. As of 2011, the average student debt in the Netherlands was €14,657.²⁶

Borrowers struggling with repayment can request a means test to qualify for a reduction or elimination of payments.²⁷ This is the income-contingent aspect of the Dutch financial aid system, and it also explains how debt could remain to be forgiven after 15 years. In essence, this is an opt-in income-contingent repayment system. The threshold for qualifying for the income-contingent repayment is based on prior-prior year earnings. For 2014, a borrower's 2012 income must have been below €24,159 (US \$39,979) for those that qualify for a single-parent tax credit, and €16,911 (US \$22,386) for those that do not qualify for the single parent tax credit.²⁸ Clearly it is not a universal IBR model, and this lack of universality may explain the low uptake in the program, explored in the discussion below.

Repayment is managed by a quasi-governmental agency (Informatie Beheer Group; IBG), which has the ability to interface with the tax authority and grant access to income-contingent repayment in something close to real time.²⁹

Discussion

The Netherlands' system is extremely generous. Considering the achievable academic benchmarks for having the loan convert to a grant, the system offers a basic grant to nearly all college-going students. The income contingent aspect of their repayment system is also generous. At low enough income levels, monthly payments are entirely forgiven, and full forgiveness occurs for all borrowers after 15 years of repayment. Largely due to the perceived generosity of the program, a comparative study of affordability of international higher education systems ranked the Dutch higher education program in the top three.³⁰ However, the 41 percent first-time graduation rate demonstrates that not all students receive the benefit of the grant conversion.

The forgiveness provision and income-contingent aspect for low-income borrowers target the benefits of the program to needier students. The hybrid nature of the Dutch system makes it less administratively demanding than a pure auto-IBR program, in that it does not rely on an assessment of the income information of every borrower, but only assesses those that fall below the threshold to qualify for income-contingent payments.

That said, students do not seem to know about the terms and conditions of the government's higher education financial aid programs, and student uptake is low. Some studies have estimated that as little as 35 percent of the available assistance offered by the Netherlands' financial aid system is being utilized by students.³¹ This may be due to the complexity of the grant-to-loan system, and the concern about uptake certainly speaks to issues of college access that any proposed repayment model based on income should account for. Clearly, this is less of a concern in an auto-IBR environment. It is also speculated that low uptake is tied to students working instead of borrowing.³² This raises concerns about academic performance, as working and studying simultaneously presents challenges of focus and time-management.

The system also seems prone to fraud, owing to its universal, basic access. Early in the previous decade, it was found that a substantial number of students were applying for and receiving their benefits without actually enrolling in postsecondary education. The Dutch government took corrective measures following these revelations, but this would seem to be a challenge inherent in the efforts to preserve the open access of the funding system.

Conclusion

This consortium's proposal for an auto-IBR system in Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk represents an ideological shift in the student loan system in the United States; a potentially complicated restructuring of the current system that would involve several government agencies. In striving for something simple, efficient and fair there is always a chance for unintended consequences; thus, there is value in looking to other countries to draw instruction from their experiences. In the two countries surveyed, there seems to be a delicate balance between uptake rate and overall cohort repayment rate. The Netherlands system suffers from a lack of participation, partially as a result of its opt-in nature, but the Australian system suffers from a substantial amount of debt that is unlikely to be repaid. Policymakers should consider this balance when they set objectives for an auto-IBR system and design the system to maximize participation while protecting against providing excessive loan forgiveness or opportunity for non-payment.

End Notes

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