



Institute of Education

Designing a sustainable income contingent loan for Colombia

**Lorraine Dearden
University College London**

Introduction

- Income Contingent Loans operate in a number of countries around the world
- First introduced in Australia in 1989 but since been introduced in New Zealand (1992), the US (1994), the United Kingdom (1998), Hungary (2001), South Korea (2011)
- However, crucial differences in how these schemes operate

ICLs are different

- Conventional time based repayment loans (mortgage style loans) involve a nominal repayment of \$ X per month for n years. With a mortgage style loan/TBRL:
 - An increase in the interest rates raises monthly nominal repayments.
 - What is fixed is the duration of the loan; the variable component is the fraction of a person's income absorbed by repayments (referred to as the *repayment burden*).
 - Because repayments stay the same (in the absence of interest rate changes), the repayment burden increases if income falls.

But with an ICL

- Repayments are x per cent of the borrower's current income until repaid or written off
- In all ICL systems:
 - payments are taken only after income reaches a threshold (to protect those facing financial stress)
 - In an ICL system the duration of repayments is variable
 - longer for borrowers with lower incomes, and unique to each debtor because the path of income is similarly unique.
 - A higher interest rate increases the repayment term NOT the monthly repayment

Why do ICLs work?

- Everybody has their own unique repayment period and their repayment burden can never exceed the ICL maximum repayment rate
- In UK, the maximum repayment period is set at 30 years whereas in Australia there is no maximum
- Colombia's new ICL has a 20 year maximum repayment period – if loan not paid off then the loan is forgiven
- ICL repayment terms are, on average, longer than with TBRLs but this is sensible as university education is an investment with lifelong benefits cf buying a car

ICL scheme needs to be appropriate to each country's specific circumstances

- Every country is different in terms of public vs private provision, income tax regime, social security system, labour markets, size of informal sector, labour market mobility etc
- Getting the loan design right is so important for protecting students AND for government revenue
- Need to use country specific micro data and robust simulation methods to get the ICL loan design right
 - Can't take ICL from other countries – design needs to be sensitive to the labour market and institutions in that country
 - But the core elements of good design apply equally across countries

Data is key

- To get any student loan design right need country specific individual level data
- I have been to many countries where student loan systems designed on the basis of the 'average' graduate
 - Projections of implications for students and government revenue can't be ascertained from an average graduate
- Need to simulate entire distribution of future graduate loan-holders earnings and earning dynamics over their lifetime to really understand how a student loan system will work

Colombia has fantastic data

- I have worked in this area for 25 years and been at the forefront of developing models to look at the implications of loan design
- Developed student loan models with colleagues in UK, US, Japan, Malaysia and Brazil
- Since 2018 been working with ICETEX team to develop a model for Colombia and never worked with such rich and comprehensive data
- Like to thank the Ministry of Education and Ministry of Labor for providing this data

What have we learned from the data?

- We have anonymized data on every ICETEX borrower, what they borrowed, their repayment history, the subject and university attended plus other characteristics
- We have their formal monthly labour market earnings between 2009 and 2020
- Means for existing cohorts we can compare an ICL to the existing system and compare revenue streams for ICETEX and compare repayments made under the two systems by students
 - Shows ICL better for both students and ICETEX

Informal labor market

- At any one point of time only around 70% of ICETEX graduates are in the formal labor market BUT
 - for males over 95% have been in the formal labor market between 2009 and 2020
 - For females just over 90% have been in the formal labor market between 2009 and 2020
- Important to incorporate movements in and out of the formal labor market as well as up and down the earnings distribution when costing an ICL
 - The more mobility the cheaper an ICL so need model that accurately to get implications and costings right

The Colombian Student Loan Model

- I worked with wonderful ICETEX researchers to develop the model using the rich Colombian data that is available

THANK YOU **GERMAN PULIDO** and **JULIANA ARAGON**

- Parameters of the loan design decided by Colombian officials
 - my role was helping them build a model that could show the implications of different designs for loan holders across the distribution of lifetime earnings
- Very similar to the models I have helped develop in the UK, US Japan, Brazil and Malaysia over the last 25 years
- But every country is different so ICLs need to be country specific

But it could be even better

- It would also be good if we had data for non-ICETEX graduates so that we could compare loan-holders and non-loan holders
 - This would be crucial to do an early evaluation of the impact of ICL on university choices and progression
 - Robust early evaluation crucial for public policy design and needs good data which Colombia has
- It would be good to have earnings of older HE graduates from the age of 35/40 (as we have to use GEIH data and make other assumptions to simulate earnings at older ages).

ICLs and access to HE

- Increasing access to higher education is something I care deeply about and has been the topic of research I have undertaken for the last 30 years
- I have written an OUP book with colleagues on this very issue



- Going to show you two examples from the book which focuses on UK

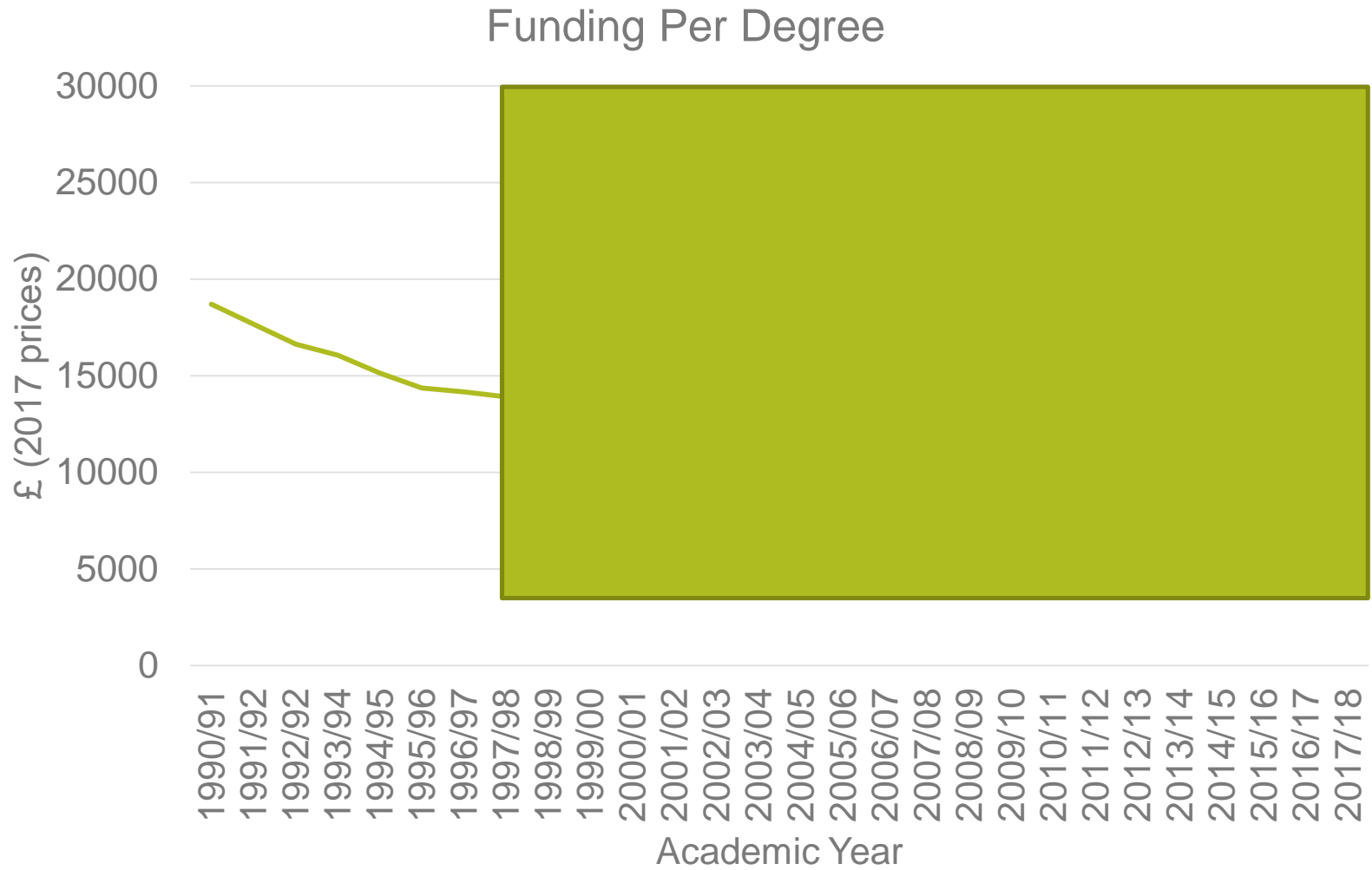
UK ICL

- First introduced in 1997 when fees were introduced in public universities (only handful of private universities in UK)
 - taxpayer costs of providing a place cheaper so have more places for same taxpayer outlay
 - No upfront cost for attending university as with ‘free’ HE so is ‘free at point of access’
 - The amount you eventually contribute is related to how well you do in the labour market and that can be different from where you come
 - In UK has provided much more upfront support for living costs, particularly for those from poor socio-economic background and resulted in huge increase in participation for those from disadvantaged backgrounds

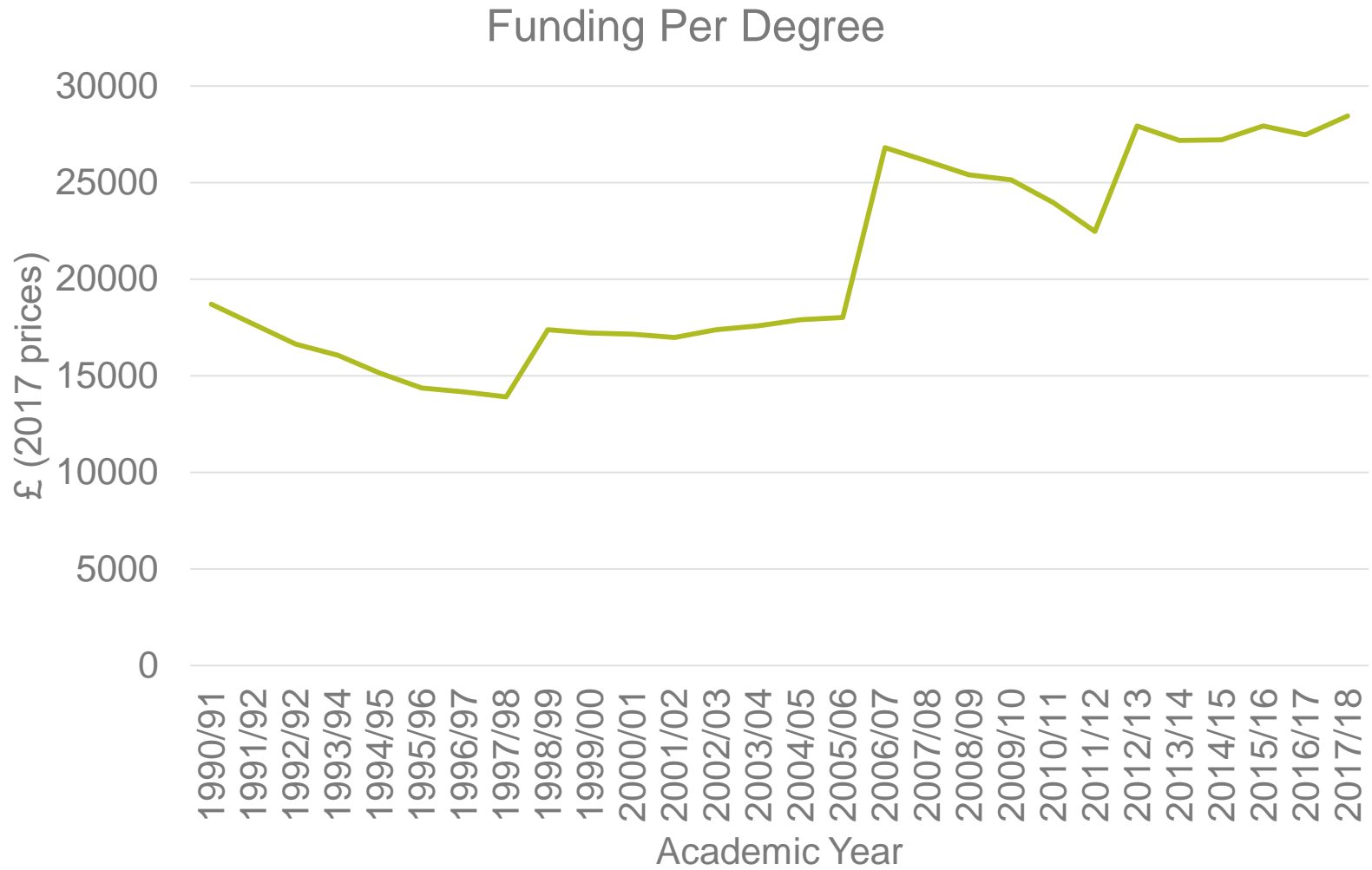
Fees + ICL = Increased funding for HE

- One of the key reasons of introducing fees in the UK was to increase funding per head for university students which had declined dramatically since the early 1980s
 - Universities were very unhappy
- What happened to university funding when fees introduced in UK?
 - Fees were capped at £1,000 pa in 1998, then at £3,000pa in 2006 and then £9,000pa in 2012 (currently £9250pa)

Impact on undergraduate funding per student? (£2017)



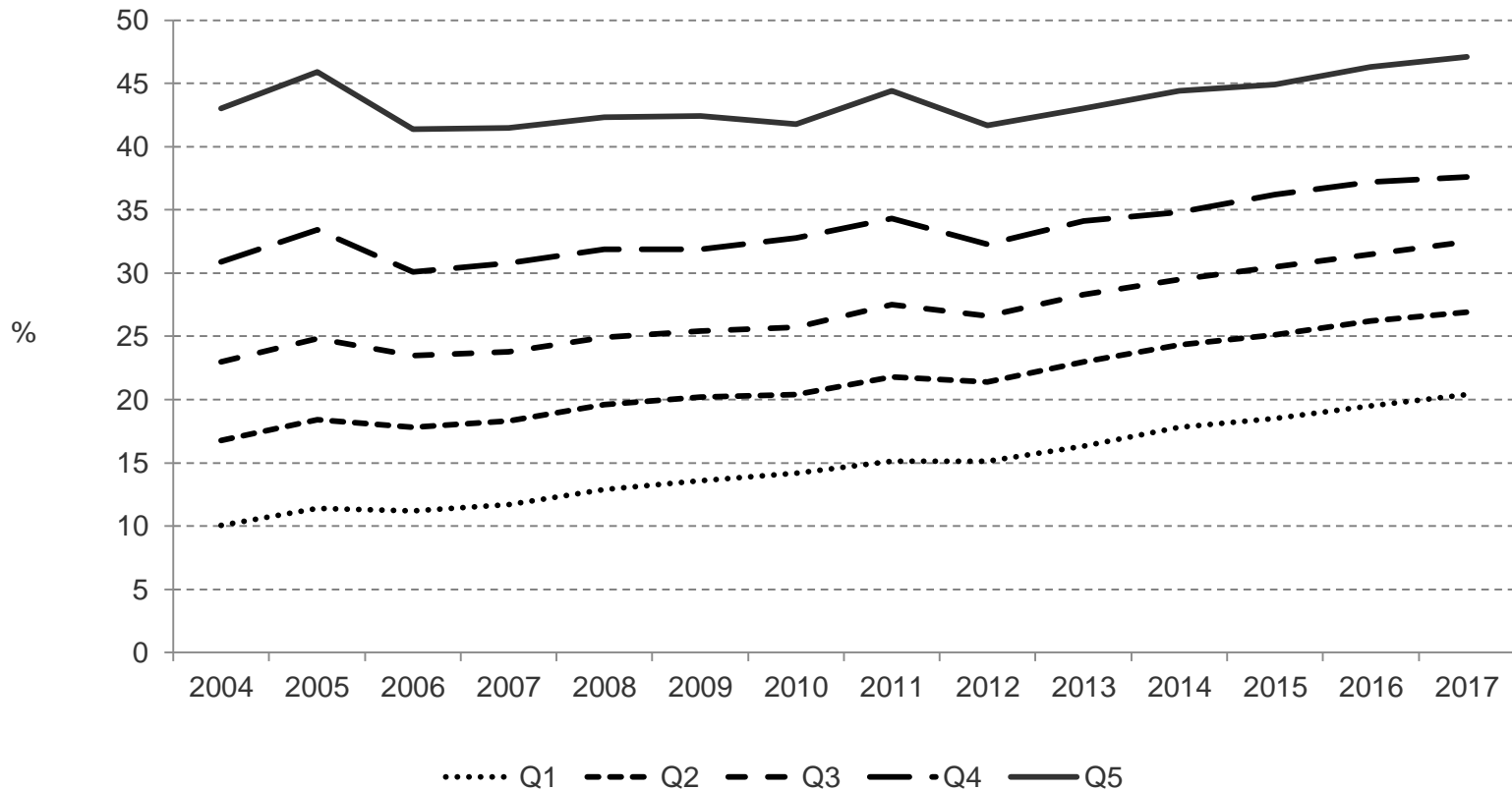
Impact on undergraduate funding per student? (£2017)



What about impact on socio-economic access to HE?

- One of the driving forces in the UK to introduce fees was to make the system bigger
 - This happened in an affordable way
- UK reforms also involved making upfront support for poor students more generous
- So how did fee reform impact on HE participation?

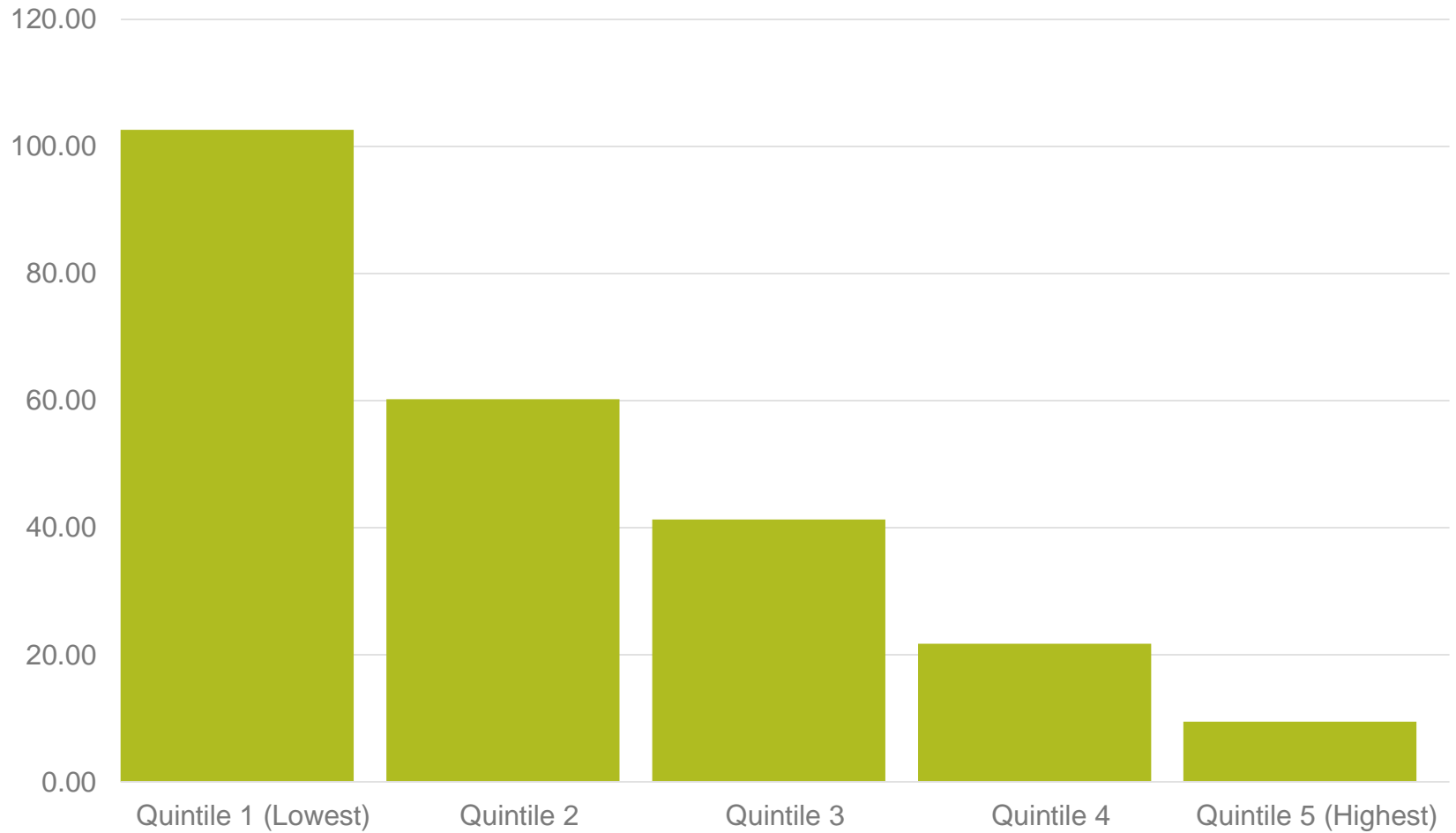
HE participation for young people by quintiles of advantage



Source: *UCAS End of Cycle Report 2017*, Figure 5.7 (2006 onwards) and 2013 Report Figure 56 (2004-5, adjusted by ratio of 2006 figures in 2017 report to those in 2016 report).

Note: Q1 is the most disadvantaged group, Q5 is the least disadvantaged.

% Growth in participation from 2004 to 2017 by quintile of deprivation



Socio-economic participation gaps have been falling while tuition fees have been rising – why?

- Student's can borrow money to cover their fees and living costs whilst at university – no upfront costs for poorest
- English system has expanded because every existing and extra place is cheaper for the government due to the introduction of fees
- Big HE systems increase access for poor
- Those who go on to be low income graduates are relatively protected from the costs of university (insurance)
- More equitable to have 'free at point of access' rather than 'free'

The new ICL in Colombia

- Should have an immediate impact on participation in HE from those from the poorest backgrounds
- There is no doubt that many poor students in Colombia don't attend HE because of fear of being able to repay their student loan
 - Poor students can only attend HE with a loan or scholarship
 - With ICL no risk of default; impossible repayment schedules; family members being chased for loan repayment etc

Further reform in Colombia?

- I think further reform will be needed in Colombia if really want to tackle inequality in access to HE
- ICL for new students is a start but much more could be done
 - Ensure it covers living costs for the poorest if maintenance subsidy not sufficient or received
 - Lots of former students struggling with repayments of student loans which would benefit from ICL (and good way to pilot repayment system)