

## Student Loans Debt Summit Paper – 6 July 2001

### Key points

- Overall, the current student loans scheme is a good means of providing access to post-compulsory education and training for a relatively large number of people;
- The alternatives of private borrowing, substantially increasing government funding for post-compulsory education, or substantially reducing student numbers are neither feasible or desirable;
- A number of improvements could be made to the scheme, including:
  - providing better information and advice to potential borrowers;
  - limiting the amounts that can be borrowed, either in a particular year, or overall;
  - setting conditions on continued eligibility to borrow;
  - increasing the repayment rates for non-residents after a given period;
  - re-thinking the trade-off between interest write-off provisions and access to student allowances and scholarships.

### Background

The New Zealand student loan scheme has been in operation since 1992. It provides low-cost (particularly when interest write-off provisions are considered) loans for students enrolled in tertiary education. It covers tuition fees, course related costs and, for full-time students, can also provide loans for living expenses. Students can borrow the full cost of tuition (except for PTE students, who are limited to \$6,500) and \$1,000 in course-related costs.

The loans attract a rate of interest of currently 7% - but this may be written-off for students still in study. Furthermore, 50% of all compulsory repayments, and any voluntary repayments, are credited to the principal.

Repayment is income contingent. No repayments are required below \$14,768. For every dollar above this, repayments of 10c are required. Non-residents must repay a non-income contingent rate of \$1,000 per annum (or 1/15<sup>th</sup> for those with debts over \$15,000).

### Key student loan statistics

Total number of borrowers (30 May 2001)	316,192
Number of overseas resident borrowers (30 May 2001)	14,254 or 4.5%
Current total debt (31 May 2001)	\$4.037 billion
Average debt (31 May 2001)	\$12,756
Total borrowed (since 1992, nominal figure)	\$4.8 billion
Total repaid (since 1992, nominal figure)	\$1.3 billion
% of eligible students borrowing (1999 figure – Student Loan Scheme Annual Report)	47.9%

## Issues & Concerns

A number of issues and concerns are raised in respect of the student loan scheme. These include:

- the overall size of debt;
- repayment times;
- ease of access to debt;
- its contribution to the 'brain drain'; and
- equity issues.

Estimates of the eventual overall size of the debt involved in the student loan scheme appear to fluctuate considerably from year to year, ranging from \$12 to \$19 billion by 2020. Already it has been indicated that the most recent calculations of the Tertiary Education Student Loan Analysis (TESLA) model overestimate debt levels by around 18%.<sup>1</sup> Furthermore, concerns about the level of overall debt are sometimes exacerbated by the fact that the figures quoted are in nominal, not real, terms. Thus a nominal debt of \$15,980 in 2020 (the most recent adjusted estimate), deflated by 3% per annum, has a value in today's dollars of \$9 billion.

Concerns are often expressed over the length of time taken to repay what is owed. For example, the Ministry of Education recently calculated that the *maximum* time it would take a nurse who borrowed the *maximum* amount for which they were eligible would take to repay their loan would be 23 years. However, it is estimated that the *average* time which it would take a borrower to repay would be 9.6 years for males and 16.8 years for females.<sup>2</sup> Concerns over the length of repayment times often conflict with concerns over the incidence of repayment. The more generous the income-contingent nature of the scheme, the longer repayment periods will be required. Repayment periods could be substantially shortened if repayment requirements were increased.

Another concern is the relative ease with which young people can access student loan debt, in comparison to other forms of debt. This is an issue which could be seriously addressed, as discussed below.

While it is often argued that the student loan scheme has contributed to the 'brain drain', the figures do not appear to support this. With only 4.5% of borrowers listed as non-resident, there does not appear to have been a 'flood' of graduates overseas – at least not at any rate greater than traditionally. Furthermore, repayment conditions for non-resident borrowers are considerably less favourable than for residents – they are not, for example, income-contingent. The key drivers for international migration continue to be higher relative wages, and a desire for overseas experience.

It is argued that the student loan scheme is inequitable, because people from lower socio-economic backgrounds are either required to borrow a greater amount than others, or conversely, are debt-averse, and thus do not participate. Furthermore, the lower lifetime earnings of women are seen as resulting in inequity. It is unclear to which extent it is the loans scheme *per se* that creates equity problems – or student contributions to the cost of education. There may be alternative mechanisms which could address equity concerns, which do not involve the loans scheme, or provide alternatives to it. With respect to women's lifetime earnings, it should be noted that a non-income contingent loans scheme, or up-front fee payments without a loans scheme, would be considerably more inequitable. Finally, the interest write-off provisions for those on low or no income mean that women who leave the workforce do not continue to accumulate debt while they have a low or no income.

---

<sup>1</sup> Maharey (2001).

<sup>2</sup> The Dominion (2001).

## **The student loan scheme – international comparisons**

By international standards, the New Zealand student loan scheme is relatively generous with respect to borrowers. The income-contingent nature of repayments, and the interest write-off provisions, make the scheme relatively favourable to borrowers. The majority of student loan schemes internationally are of the 'mortgage' loan type – they have a fixed repayment rate, irrespective of income, and often bear real rates of interest.

The student loans schemes of Sweden and the Netherlands are comparable to New Zealand's. The Swedish system has been running since 1962, and covers living expenses. Repayment is fixed percentage of income (at a flat rate). The Netherlands scheme has a rate of interest which is equal to the government's cost of borrowing, plus 1%. Repayments are for fixed amounts, except for low income earners, for whom repayment is income-contingent.

## **Comparative debt levels**

It is important to keep the student loan scheme, and associate debt levels, in perspective. Current household debt (as at March 2001) stands at \$71 billion.<sup>3</sup> Of this, 2 billion is interest bearing personal credit card debt, with a current interest rate of 18.3%.<sup>4</sup> Household debt rose 5.8% from March 2000 to 2001, while interest bearing personal credit card debt rose 17% from June 2000 to April 2001.

Adjusting for solely for inflation, and assuming (somewhat conservatively) that household debt and credit card debt will *not* continue their rapid growth rates, these will equate to \$125 billion in 2020.

## **Alternatives to Student Loans**

Students have opposed the student loan scheme since its inception, for many of the reasons outlined above. But if we were to do away with the scheme, what would we replace it with? There are three main alternatives to the current loans scheme (other than a different form of loans scheme):

- students borrowing privately; or
- increased government funding for tertiary education; or
- reduced numbers of students (for the same amount of funding).

### **Private borrowing by students**

If there were no government provided student loans, students would need to borrow privately in order to finance their studies. This would have a number of effects, all of them negative in comparison to the current scheme.

First, access to credit would not be universal. Private lenders would conduct risk assessments of potential students, and only those with a reasonable expectation of repayment would be able to borrow. This would most likely reduce the ability of students in areas with less certain rates of return (e.g. the humanities), and would also probably reduce access for those from lower socio-economic backgrounds, due to lower credit ratings and lower statistical rates of return.

Second, the loans would be fully interest bearing, at a rate considerably higher than is currently the case. Current credit card interest rates are around 18.3%. Loans to students might generate a lower interest rate, but only where expected rates of return were high.

---

<sup>3</sup> NZEIR *et al* (2001).

<sup>4</sup> Reserve Bank (2001).

Third, there would be no provisions for interest write-offs, either while studying, or during periods of lower earnings. Indeed, repayments would not be income contingent. Borrowers would be required to pay back their loan at a given rate, irrespective of their income.

Under such an arrangement, fewer students would have access to loan finance, at a higher cost. Overall debt levels would be substantially higher, and interest paid would form a substantial part of the overall cost of post-compulsory education.

## **Increase government funding**

The option which is probably favoured by students is an increase in government funding for tertiary education, to a level which would make borrowing for tuition and living expenses unnecessary. But the increase required would be substantial.

In 2000, there were around 176,000 EFTS in tertiary education, and total government expenditure through the EFTS system was around \$1.2 billion. Assuming that this accounts for approximately 70% of the cost of tuition, then the total required to 'fully fund' tertiary education would be \$1.8 billion – at least a further \$600 million.

And this only relates to tuition – if you wanted to replace loans for living expenses with student allowances, then you would need a further \$4-500 million. In all, over \$1.1 billion per annum would likely be required. This is nearly 10% of the whole income tax take, and 3% of the whole tax take – which is only \$37 billion.<sup>5</sup>

This could only come from two sources:

- reallocations from other areas of government expenditure (hospitals, primary schools?); or
- increases in taxation.

While increasing taxation rates may be attractive to some, it is very important to note that New Zealand's tax take as a percentage of GDP is considerably higher than that of our key trading partners (e.g. Australia, Japan, the US). It is also important to consider the growing body of evidence<sup>6</sup> that suggests that our current tax take, as a percentage of GDP (at around 35%) is far higher than optimal for economic growth – and consequently for the tax take itself.

In any case, New Zealand does not have a very great capacity to absorb further tax increases. Even prior to the increase in the top marginal income tax rate to 39%, the top 15% of income earners were paying 57% of all income tax (and the top 5%, to whom the new top rate largely applies, were paying 33% of all income tax).<sup>7</sup>

## **Reduce student numbers**

There were 176,000 EFTS in tertiary education in 2000. If the average 'full-cost' of delivering tertiary education is \$10,134, and there were only the current \$1.2 billion or so available, then it would be possible to provide only 123,000 EFTS – 53,000 fewer EFTS. Of these, 28,000 or so would have to be university students.

Reducing student numbers might be seen as desirable by some, who current perceive that much of tertiary study is 'wasted' on inappropriate subjects (although the subjects considered 'inappropriate' vary).

---

<sup>5</sup> Cullen (2001).

<sup>6</sup> see Scully (1991).

<sup>7</sup> Statistics New Zealand (2001).

On the other hand, there is strong evidence that shifts in the kinds of work and industries which are generating wealth have led to increasing levels of skill and knowledge requirements. Growth in student numbers has occurred *in spite of* substantial increases in the cost of tertiary education – so there must be powerful drivers in favour of tertiary study. Arbitrarily reducing participation levels is likely to have a substantial impact – in all likelihood a much greater impact than that of student debt levels.

## Possible changes to Student Loans

Assuming that neither of the possibilities outlined above are likely (irrespective of whether they are desirable or not), then what changes might be put in place to improve the loans scheme?

Some possibilities include:

- providing better information and advice to potential borrowers;
- limiting the amounts that can be borrowed, either in a particular year, or overall;
- setting conditions on continued eligibility to borrow;
- increasing the repayment rates for non-residents after a given period;
- re-thinking the trade-off between interest write-off provisions and access to student allowances and scholarships.

### Advice prior to borrowing

It seems that considerably greater effort could be put into ensuring that students made good choices prior to borrowing. If borrowing using the student loans scheme is a major and substantial investment, with significant ongoing financial consequences, then it should be treated in a manner similar to other major financial investment decisions.

It would be possible to require prospective borrowers to obtain independent advice on the advisability of their prospective investment. An important part of this process could be requiring providers of tertiary education seeking to offer programmes eligible for students loans to provide a 'prospectus' which covered issues such as expected rates of return and other (including non-financial) benefits of the programme.

Such advice could be part of a broader, ongoing process of learning and career planning – something which is woefully lacking in our schools and society.

### Limits on borrowing levels

If there are concerns that the availability of students loans is driving up the price and or availability of 'inappropriate' programmes, or enabling learners (even in the face of advice such as that discussed above) to take on unsustainable levels of debt, then limits might be set on the total amount of borrowing – either in a given year, or overall, or both.

There is currently a limit of \$6,500 per year on the tuition related component of borrowing for students studying with PTEs. A similar limit might be imposed for all providers – either at a flat rate, or tied to funding rates.

It would be equally possible to set an overall borrowing limit – of say \$100,000. It could be argued that students who can legitimately justify borrowing more than \$100,000 are likely to have no difficulty obtaining finance beyond that point.

## **Conditions on borrowing**

A further constraint which could be introduced would be to place conditions on ongoing borrowing, including requiring that students pass a certain percentage of their studies. This could, however, penalise students who performed badly in one year from ever being able to return to study. An alternative might be to provide incentives (such as the write-off of a percentage of the loan) for successful completions, rather than a penalty.

## **Increase repayment rates after 4 years of non-resident status**

Should it become apparent that the loans scheme is becoming a contributing factor to emigration, consideration could be given to changing the way in which the scheme operates for non-residents. If the repayment rates were to be increased, then the incentives to migrate would be reduced, and the incentives to stay in New Zealand would be increased.

It would be wise to keep the repayment rates for short-term non-residents (less than 4 years) to a reasonable level, as New Zealand benefits from the 'OE' of its citizens, and it is desirable to encourage them back after a period.

## **Interest Write-off / Student Allowances / Scholarships trade-off**

Finally, further consideration should be given to the extent to which the newly introduced higher level interest write-offs promote equitable outcomes.

The interest write-off policy is a costly one – as a result of this policy change, interest write-offs are predicted to increase from \$24.6 million in 1999/00 to \$199.0 million in 2002/03.<sup>8</sup> The majority of the benefits of these new write-offs will accrue to students in longer programmes and those with higher incomes.

Careful consideration should be given to whether these funds could not be better used to promote more equitable outcomes. These funds might have more equitable outcomes if they were used to either increase eligibility for student allowances, or in the greater provision of tuition scholarships for those from lower socio-economic backgrounds.

The \$150 million or so the write-offs cost could provide 15,000 students with \$10,000 scholarships – which could be allocated on a range of criteria. If equity is a serious concern, then this should warrant serious consideration.

Jeremy Baker

**Adviser Education and Training**

---

<sup>8</sup> Ministry of Education (2000).

## References

- Cullen, Michael (2001) *Budget 2001 – Economic and Fiscal Update*, Wellington.
- Guille, Marianne (2000) *Student Loans in Europe – An Overview*, Paris.
- Statistics New Zealand (2001) *Model 1: Mean taxable income and mean tax paid for 1998/99, using actual 1998/99 data* (Unpublished), Wellington.
- Maharey, Steve (2001) – Letter to Chris Hipkins, President, Victoria University of Wellington Students' Association, 26 June 2001.
- Ministry of Education *et al* (2000) *Student Loan Scheme Annual Report*, Wellington, December 2000.
- Ministry of Education (2001) EFTS Statistics for 2000 (unpublished).
- NZIER *et al* (2001) *Household Savings Indicators*, Wellington, March 2001.
- NZPA (2001) *14,000 NZers Overseas Owe \$190 million in student loans*, Wellington, June 20.
- Reserve Bank of NZ (2001) *Credit Card Statistics: balances outstanding, limits and interest rates*, April 2001.
- Scully (1991) *Tax Rates, Tax Revenue and Economic Growth*, Austin, Texas.
- The Dominion (2001) *Students Face 20-yr Debt*, Wellington, Thursday 5 July 2001, page 8.

## Attachments

- Student Loan Data – 1992-2003** (sourced from Student Loan Scheme Annual Report 2000).
- Non-Resident Borrowers – 31 May 2001** (sourced from NZPA (2001)).
- Inflation adjustments to debt levels** (sources: NZIER (2001), Maharey (2001)).
- Alternatives to Student Loans** (Source: Ministry of Education (2001)).

## Student Loan Data - 1992-2003

	Actual									Forecast		
	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Opening balance	0	92.9	281.7	568.4	921.6	1382.4	1863.7	2449.8	2970.7	3520.8	4080.8	4667.3
Amount Borrowed	92.9	240.4	330.7	406.3	441.8	541.8	657.3	623.7	701.3	843.7	930.1	996.5
Accrued Interest		6.7	32.4	61.7	109	133.2	183.2	223	240.8	319.9	413.2	470.4
sub-total	92.9	247.1	363.1	468	550.8	675	840.5	846.7	942.1	1163.6	1343.3	1466.9
Capital Repayments		-8.6	-20.7	-35.3	-59.9	-88.4	-116.4	-147.5	-174.1	-217	-287	-351
Interest Repayments		0	-4.8	-13.5	-24.7	-34.7	-52.2	-92.1	-107.4	-141.1	-190.6	-236.2
sub-total	0	-8.6	-25.5	-48.8	-84.6	-123.1	-168.6	-239.6	-281.5	-358.1	-477.6	-587.2
Write-offs		0	0	-2.3	-8	-13.4	-19.3	-24.8	-24.1	-157.5	-181	-199
Doubtful-debts		-49.7	-50.9	-63.7	2.6	-57.2	-66.5	-61.4	-86.4	-88	-98.2	-87.3
sub-total	0	-49.7	-50.9	-66	-5.4	-70.6	-85.8	-86.2	-110.5	-245.5	-279.2	-286.3
Net change	92.9	188.8	286.7	353.2	460.8	481.3	586.1	520.9	550.1	560	586.5	593.4
Closing balance	92.9	281.7	568.4	921.6	1382.4	1863.7	2449.8	2970.7	3520.8	4080.8	4667.3	5260.7
Cumulative additions												
Borrowings	92.9	333.3	664	1070.3	1512.1	2053.9	2711.2	3334.9	4036.2	4879.9	5810	6806.5
Interest	0	6.7	39.1	100.8	209.8	343	526.2	749.2	990	1309.9	1723.1	2193.5
sub-total	92.9	340	703.1	1171.1	1721.9	2396.9	3237.4	4084.1	5026.2	6189.8	7533.1	9000
Cumulative Repayments												
Capital	0	-8.6	-29.3	-64.6	-124.5	-212.9	-329.3	-476.8	-650.9	-867.9	-1154.9	-1505.9
Interest	0	0	-4.8	-18.3	-43	-77.7	-129.9	-222	-329.4	-470.5	-661.1	-897.3
sub-total	0	-8.6	-34.1	-82.9	-167.5	-290.6	-459.2	-698.8	-980.3	-1338.4	-1816	-2403.2
Cumulative write-off												
Write-offs	0	0	0	-2.3	-10.3	-23.7	-43	-67.8	-91.9	-249.4	-430.4	-629.4
Doubtful debts	0	-49.7	-100.6	-164.3	-161.7	-218.9	-285.4	-346.8	-433.2	-521.2	-619.4	-706.7
sub-total	0	-49.7	-100.6	-166.6	-172	-242.6	-328.4	-414.6	-525.1	-770.6	-1049.8	-1336.1

Source: Student Loans Annual Report (2000)

**Student Loan Data - 1992-2003 (continued)**

	Actual									Forecast		
	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
<b>Rates of change</b>												
Borrowings		159%	38%	23%	9%	23%	21%	-5%	12%	20%	10%	7%
Interest			384%	90%	77%	22%	38%	22%	8%	33%	29%	14%
Capital Repayments			141%	71%	70%	48%	32%	27%	18%	25%	32%	22%
Interest Repayments				181%	83%	40%	50%	76%	17%	31%	35%	24%
Write-offs					248%	68%	44%	28%	-3%	554%	15%	10%
Doubtfull-debts				25%	-104%	-2300%	16%	-8%	41%	2%	12%	-11%
Total Owed		203%	102%	62%	50%	35%	31%	21%	19%	16%	14%	13%

Source: Student Loans Annual Report (2000)

**Non-Resident Borrowers**  
**31-May-01**

		<b>Amount owing</b>	<b>Average</b>
<b>Total no. of borrowers</b>	316,192	\$4,037,338,064	\$12,769
<b>No of overseas resident borrowers</b>	14,254	\$189,674,338	\$13,307
<b>Percentage of overseas residents</b>	<b>4.5%</b>	<b>4.7%</b>	

*Source: NZPA (2001)*

## Inflation adjustments to debt levels

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
<b>Average inflation</b>	3%									
Household Debt	<b>71,340</b>	73,480	75,685	77,955	80,294	82,703	85,184	87,739	90,371	93,083 (Mar 2001)
High SL debt	10,876	11,212	11,559	11,917	12,285	12,665	13,057	13,461	13,877	14,306
Revised SL debt	8,918	9,194	9,478	9,772	10,074	10,385	10,707	11,038	11,379	11,731

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Household Debt	95,875	98,751	101,714	104,765	107,908	111,145	114,480	117,914	121,452	125,095
High SL debt	14,748	15,205	15,675	16,160	16,659	17,175	17,706	18,253	18,818	<b>19,400</b> (TESLA model)
Revised SL debt	12,094	12,468	12,853	13,251	13,661	14,083	14,519	14,968	15,431	<b>15,908</b> (less 18%)

Sources: NZIER (2001), Maharey (2001)

## Alternatives to Student Loans

<b>Increased Government Funding</b>			
<b>Tuition</b>	2000/01 All Providers	Universities	Non-Uni
Total EFTS funding	\$1,245,344,431	\$728,016,648	\$517,327,783
Estimated Total Cost	\$1,779,063,473	\$1,040,023,783	\$739,039,690
Additional Cost - Tuition	<b>\$533,719,042</b>	<b>\$312,007,135</b>	\$221,711,907
(this does <b>not</b> include increases required to provide student allowances)			

<b>Reduced Numers of Students</b>			
	2000/01 All Providers	Universities	Non-Uni
2000/01 EFTS	175,560	94,396	81,164
Average funding	\$7,094	\$7,712	\$6,374
Required 'full-cost' funding	\$10,134	\$11,018	\$9,106
No of 'full-cost' EFTS possible (with 2000/01 funding)	122,892	66,077	56,815
Reduced no of EFTS	<b>52,668</b>	<b>28,319</b>	24,349

Source: Ministry of Education (2001)