Joint Oireachtas Committee on Education and Skills

Opening Statement on the Report of the Expert Group on Future Funding for Higher Education by Dr. Aedín Doris, November 24, 2016.

Introduction

My contribution to the Report of the Expert Group was to assist the Group by sharing with them the results of research that I have been undertaking on the viability of income-contingent loans in the Irish context. In this statement, I will therefore focus mainly on the third option that the Report discusses, namely the student loans option.

The results of some of the analyses I have conducted are contained in the Appendix to the Report. I do not intend to go through these results in detail. Instead, I will give a broad overview of the rationale for income-contingent student loans and the issues that need to be considered in order to implement such a system in a way that results in a level of repayments that is fiscally acceptable without placing an unreasonable burden on graduates.

Rationale for Income-Contingent Loans

I begin by explaining why income-contingent student loans are being considered as a way of funding investment in higher education in an increasing number of countries. In these remarks, I will take it as given that students are expected to pay a contribution to the cost of their education.

The key problem with charging fees for higher education is that, while returns to higher education are high on average, they are not the same for everyone; they vary substantially according to the discipline studied, the employer and also due to differences in life circumstances – illness, childcare responsibilities etc.

Because of the risk of non-repayment if a student turns out to be one of the unlucky ones who ends up with low earnings, banks do not generally offer loans to students, so they must rely on their parents to either give them the money or to borrow on their behalf. But if parents do not have savings and do not have the ability to borrow – perhaps because they themselves have low earnings and/or no collateral to offer – some students who could benefit from higher education will not be able to access it, resulting in too few graduates being produced. This is both inefficient and inequitable, since those who cannot access funds are those whose parents are worst off, resulting in intergenerational mobility being curtailed.

Income-contingent loans (ICLs) are designed precisely to solve the problem of earnings risk. The basic principle behind them is that repayments are made only to an extent that is affordable. Affordability is ensured by placing an explicit cap on the proportion of earnings that can be taken up by repayments; this is typically in the range of 5-10%. Thus, income-contingent student loan debt should not be thought of as debt in the usual sense – it is debt that has to be repaid only if the graduate can afford it. Repayments fall to zero in months when earnings are low or zero. Thus, there is no possibility of hardship due to loan repayments.

As you will know, ICLs have been introduced in several countries, including Australia, New Zealand, England and Hungary. However, these systems differ from each other in the specifics of their designs. Moreover, graduate earnings over the life-cycle follow different paths in different countries. Because of these differences, these systems entail different repayment patterns and different levels of government subsidy. Therefore, it is important to consider how alternative designs would work when applied to Irish graduate earnings.

Important Parameters of Income-Contingent Loan Systems

The parameters of ICLs are the rules that govern whether and how quickly the loans are repaid. These include: the earnings threshold beyond which repayments start; the earnings base on which repayments are calculated; the rate at which repayments are made; the interest rate charged, if any; and the date at which outstanding debts are written off. The total amount borrowed is also important in comparing alternative systems.

In my work for the Expert Group, I considered how varying some of these parameters – particularly the earnings base and the interest rate, but also the amount borrowed – affects both the fiscal sustainability of the scheme and the affordability of repayments. I will briefly explain these in turn.

Fiscal sustainability is typically measured using a figure that gives the proportion of the total debt that is not repaid; this is often referred to as the government subsidy. It is important to note that non-repayment of an ICL is a feature of the system, not a flaw. ICLs are designed so that those who do not benefit from their qualifications do not pay for them. Nevertheless, it is important for fiscal planning to have a good idea of what the figure will be in advance of such a scheme's introduction.

Affordability can be measured in many different ways. In my work, I calculated the number of years in which repayments were made; the proportion of gross and net earnings accounted for by the repayments; and the mean monthly payment, averaged over the years of repayments.

Analysing Alternative Income-Contingent Loan Schemes

To conduct the analysis of the various alternative schemes, the most important ingredient is a reasonable representation of graduate earnings across the entire distribution. Knowing how the average or median graduate's earnings evolve over the life-cycle is of little use, since these graduates typically have no difficulty in repaying their loans in most systems; it is the graduates towards the bottom of the earnings distribution that are of greatest concern.

I based my analysis for the Expert Group on a methodology I have used in joint research with Bruce Chapman of Australian National University that models graduate earnings in great detail across the distribution and separately for men and women; this latter point is important as women earn less than men over the life-cycle, and tend to work part-time to a greater extent than men during the middle years of their careers.

Once life-cycle earnings profiles have been modelled, the analysis entails applying the rules of alternative schemes to those profiles and then taking into account labour force non-participation, unemployment and emigration. In doing this, I assumed that 20% of graduates emigrate, with half of those (i.e. 10% of graduates) staying abroad permanently and another half leaving temporarily. I made the conservative assumption that emigrants pay nothing towards their student loans while abroad.

A further conservative assumption that I made is that there will be no productivity growth in the economy in the future, implying that real wages for graduates will stay at their current levels for the foreseeable future. I should mention that in research I have completed since I contributed to the Expert Group's report, I have made the more realistic assumption that productivity growth of 1% per annum occurs.

Results

To summarize the results regarding affordability, I found that, for the parameter combinations considered, repayments are quite affordable, varying between €100-€150 per month for a graduate with median life-cycle earnings. The loan is typically paid off over 10-15 years. The longer times apply to scheme designs in which a positive real interest rate is charged, and where repayments are based on marginal income (i.e. only that portion of income above the threshold) rather than being based on total income once the earnings threshold has been reached.

In terms of the size of the government subsidy required, I found that for the schemes where a positive real interest rate is charged, the estimated subsidy is about 30%; this figure allows for time discounting – i.e. for repayments received in the future to be given lower value than repayments in the present. The discount rate I used is 2%. Any productivity growth in the economy in years to come will lower the subsidy below this figure.

One lesson that came from the analysis I conducted is how important emigration is to the size of the subsidy. The emigration scenario that I have assumed adds about 10% to the government subsidy compared to a scenario with no emigration. If a mechanism can be found to increase repayments by emigrant graduates above the zero level that I have assumed, the subsidy will be substantially reduced.

In conclusion, I wish to stress that I have investigated only a few of the many possible specifications of student loan schemes. As the Expert Group's report mentions, if an ICL were to be recommended, further research should be done before settling on the final combination of parameters that would govern the scheme.