

10. STUDENT LOANS IN EUROPE: AN OVERVIEW¹

Marianne Guille

Education is expensive. In 1995 the average global effort in favour of education represented 6.7% of GDP in OECD countries, and this effort is still largely due to the public sector.

The conjunction of three reasons might explain the recent developments in the efficiency of this financing. First, education is not a pure public good. Second, as a consequence of the spectacular rise in the number of graduates and students since the end of the 1960s, especially in Europe, public budgets on education experienced a rapid growth and are nowadays one of the most important public budgets in many countries. Third, at the same time government budget constraints became harder, leading to an extended period of financial stringency.

In developed countries, the debate focuses on the financing of higher education for several reasons: the rapid growth of this budget; the persistence of social inequalities despite extensive public financing, especially in Europe; and primary and secondary education being almost entirely free and publicly funded, which is generally admitted.

Because education is not a pure public good, one response to this funding crisis is to increase, at a significant scale, private funding of higher education. This strategy is supported particularly by the World Bank, whose recommendations, based on efficiency and equity considerations, are relayed by numerous studies. In most cases, they recommend first of all an increase in tuition fees and second, a reform of student aid schemes. This reform is often oriented towards the creation of a public credit market of education in order to finance the costs of higher education by specific loans to students. According to this system, the State has to advance this financing only during the first years of its creation, since students re-pay their loans once they have completed their

¹ The full paper is available at the PURE web-site www.etla.fi/PURE.

studies. The State has also to finance the difference between interest cost and interest income, if any, and the cost of the default rate.

This strategy provides funding for higher education, while the number of students may increase sharply without endangering public finance. It has a price, however: rising students' participation in the funding. Of course, this refusal to increase public-sector funding is justified by both efficiency and equity considerations.

Introducing fees and converting aid schemes into loan systems increase the students' financial burden, but as they receive the greatest benefit from education, it may be considered as an investment. Economic efficiency is also better served when individuals pay directly for services they receive compared to raising taxation. Moreover, there is little evidence on low fees and maintenance grants having encouraged the participation of children from poor families. Equity is then better served by an increase in students' financial participation, if those who benefit the most from public subsidies are from middle or upper social classes.

However, even though students are the main recipients of the benefits of education, they are not the only ones. Social returns exist as well. The efficient solution then is a mix of private and public funding. As a consequence, social returns must be evaluated not only to set priorities for future educational investments but also to allow comparison with private returns in order to choose an efficient mix of private and social funding that avoids over-education, if higher education is too heavily subsidised, as well as under-investment in the opposite case.

Why not private loans? First, because public loans are intended to replace or complete grants. Second, because banks would ration students to cope with information problems, especially those who do not have sufficient collateral. Banks have no interest in enhancing education, opposite to governments, as has been shown in endogenous growth models *à la* Romer.

On this basis, several countries have raised their tuition fees, especially in Europe where they were very low until the 1980s, and/or have expanded their systems of student loans, which are mostly funded by public sources. Australia and New Zealand, for instance, have created public contingent loan systems: the re-payment of these loans depends on the borrower's income, includes no real rate of interest, and is organised by taxation authorities.

What about Europe? To the extent that countries have defined needs-based national support schemes, they vary substantially according to rules for eligibility, social conditions for support and student needs, and the way the support is given. About half of the European countries provide this kind of support at least partly on a loan basis. The rest of this chapter presents an overview of these different systems of public loans to students.

All countries having developed public systems of student loans belong to the North or Mid-Western Europe: the Nordic countries, Netherlands, Germany and the United Kingdom. Although national support schemes are difficult to compare and to interpret, these countries are also clearly the ones that provide the highest support to students. This is especially true for the Nordic countries, while Southern European countries provide the lowest support.

This fact reflects differences in students' behaviour and social role: the more students live independently the more help they are given, and the more they are considered to be young citizens investing in their future the more important is the loan component of this aid. This holds especially for the Nordic countries, which were the first to design student loan systems during the fifties and, to a lesser extent, for the UK.

In Southern European countries, in contrast, where more students live with their parents, they are considered as children in a family system. Hardly any support is then provided to cover their direct expenditure on education. Mid-West European countries are in-between as they add a welfare component to this system: they provide financial aid to a large number of students but this aid depends on parental resources.

The public loan systems that have been adopted in Europe remain dependent on these differences in students' behaviour and social role, but also on the observed private returns to education. For instance, the most recent Swedish reform of the student loan system adopted in 1989 was motivated by such considerations. As private returns to education are low in Sweden², the government decided to restore the attractiveness of student loans by reducing the part re-paid by students to 70%. Ten years later, the British government decided exactly the opposite: to abolish grants and to provide students with an income-contingent loan-based aid. This choice was motivated by the

² According to PURE estimates they are the lowest in Europe, see Chapter 2 of this volume.

considerable increase in the number of students and the fact that they receive excellent returns to their investment in education.³ Hence, an increase in the cost of their investment was not expected to reduce their enrolment in higher education.

The major difference between European student loan systems resides in the importance of the loan and the way it is re-paid. The importance of student loans varies between 31% and 100% of the financial aid, while its amount may or may not depend on parental resources and on the student's way of living. The proportion of beneficiaries varies from 10% to 70% of the students.

The re-payment may or may not be related to the borrower's income. The period of grace varies between zero and five years after the completion of studies. The interest rate varies between 0 and 8.5%. Interest begins to be charged during the period of study (DS) or only after (AS) and may or may not be tax deductible.

Table 10.1. Differences in student loan systems for selected PURE countries

1997	Grant	Loan	Income-contingent	Interest Rate
Denmark	66%	34%	No	4% (DS) 4.5% (AS)
Germany	50%	50%	No	0
Netherlands	69%	31%	No	5.7% (DS, AS)
Norway (1995)	26%	74%	No	7.5 or 8.5% (AS)
Sweden	28%	72%	Yes	6% (DS, AS)
UK	58%	42%	No	No real rate (2.7%)
UK (1999)	0	100%	Yes	No real rate

Accordingly, private costs and benefits of student loan systems are very different from one European country to another. Hence, these systems have not reduced the differences in schooling costs borne by European students or their families.

³ According to PURE estimates, only Irish students receive higher returns, see Chapter 2 of this volume.

As a consequence, taking the private cost side into account in the estimation of returns to education and not only the benefit side, namely the increase in earnings from an extra year or cycle of education, might change the results obtained when comparing European returns. Moreover, a harmonisation of the funding policies of higher education seems to be necessary. Otherwise, students may vote with their feet, i.e. to choose to study in countries where their financial participation is most limited and to work afterwards where returns are highest.