

Chapter 1

Introduction:

Issues in and Analytical Frameworks for Tuition and Student Financial Aid Policies:

Lessons for Japanese Higher Education

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Chapter 1 Introduction:

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1. Issues

In this report, we will discuss six issues regarding student financial aid policies in higher education. It is very important that we discuss these issues in a way that recognizes them as mutually being related; tuition fees and student financial aid, in particular, should be considered as a set. The analytical framework and main issues are as follows:

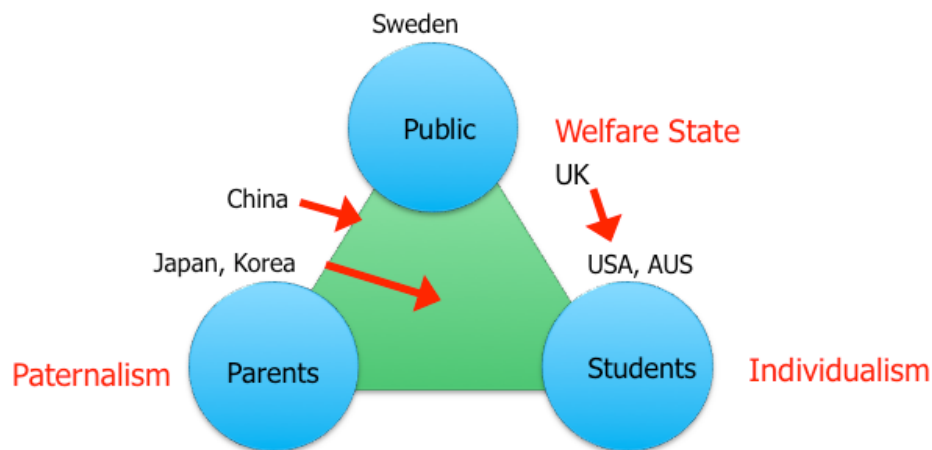
- (1) Cost-sharing in higher education
- (2) Improving access to higher education and affordability
- (3) Rising costs of higher education
- (4) Borrowers' loan burden and loan aversion problem
- (5) The evaluation of student loan repayment schemes
- (6) The information gap and financial literacy

Each paper deals with these issues, and provides lessons for Japan. I will briefly outline the main points of the six issues while explaining the situation of higher education in Japan.

2. Cost-sharing in higher education

The first issue is cost-sharing in higher education and policies that combine a consideration of tuition fees at universities and colleges with student financial aid programs.

The differences in cost-sharing in higher education among countries are deeply rooted in the differences in educational philosophies, each one of which is unique to each country, as they all have for their background different cultural, social and economic traditions. These philosophies are classified into three types (Figure 1).



Source: Yano 2012 revised by the author.

Figure 1 Three models and philosophies of education

One philosophy is widely seen in Europe, in particular in Nordic countries such as Sweden. This philosophy is that education should be sustained by society. The backbone of this philosophy is the view of the welfare state. Thus, educational expenditure is covered by the government. Tuition fees at higher education institutions are not charged or are very low in these countries. In Sweden, even three private higher education institutions are entirely free. We call this type of cost sharing “Public”.

Second, we observe the philosophy of paternalism in East Asian countries such as Japan and Korea. In these countries, it is believed that the family, usually the parents, are responsible for the education of their children. Therefore, the family or parents should pay for the education of their children. We call this philosophy Paternalism. Thus the burden of paying for the education of their children is the heaviest in these countries, and public expenditure on education is insufficient. We call this type of cost sharing “Parents”.

Third, we observe a philosophy where the students themselves are responsible for their education. They should pay for their educational costs. Of course it is difficult for young persons to pay for their education while attending school. They may get some money from part-time jobs, but this is not enough to pay for their education. Thus, they will borrow money for their education and repay it after graduation. This is typical in Australia and England. In the background of this cost-sharing is individualism. We call this type of cost sharing “Students”.

Many countries seem to be moving toward individualism, that is, the mega-trend of cost-sharing is shifting from public to private, except for some Nordic countries, and the family’s burden for higher education is shifting from parents to the students themselves. What will happen to access and cost sharing in higher education in Japan, if this is

correct? This is an important research question. Each contributor will discuss it while considering the experience of their own country.

Related to the cost-sharing issue, I would like to underline that it is very important to analyze the combination of tuition fees and student financial aid policies. From this perspective, we provide an overview of trends in tuition fees and student financial aid in Figure 2. The horizontal axis is tuition fee policy and the vertical axis is student financial aid policy, especially student grants and scholarships. Most public universities in various countries are located in the top left of the figure, low tuition/ high aid, but are moving to the right (a high tuition fee policy) very rapidly. It is interesting that the trends in English and Chinese universities are very similar. By contrast, other European universities have not moved drastically. US public universities are shifting from low tuition/ low aid to high tuition/ high aid, but Japan's national universities are moving from low tuition/ low aid to high tuition/ low aid. The same trend is seen in the case of Japanese, Chinese, and Korean private universities and colleges. The most distinguished feature of the policy in this figure is the high tuition/ high aid policy of US private universities and colleges. One must be careful to note that net tuition is very different in all of these policies.

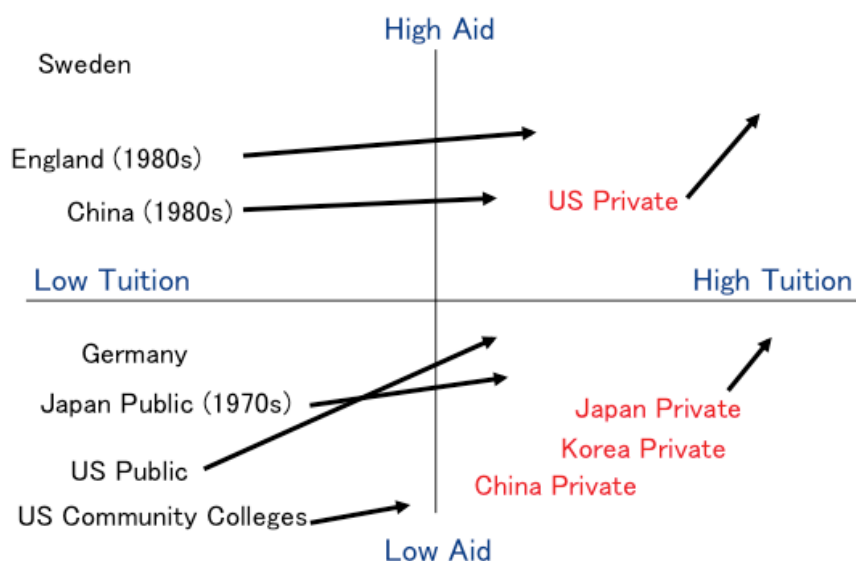


Figure 2 Trends in tuition fees and student financial aid policy in various countries

Why are policies shifting to high tuition/ high aid ? What are the factors behind this shift? Figure 3 employs the same analytical axes as Figure 2. The most important role of traditional universities was to foster elites. Therefore, a large amount of public funds was spent for this purpose. The graduates were very small in number and the public financial burden was not so heavy that the government was unable to adopt a low tuition or

tuition-free/ high aid policy.

Educational demand has been increasing in this age of higher education massification. The need for various kinds of professionals is the driving force behind this massification. As the number of university students is increasing, it is difficult to maintain low tuition/ high aid with public money, and the policy is shifting to low tuition/ low aid. Furthermore, the massification of higher education continues, and the demand for higher education surpasses supply. Private universities have been established to fill the gap. This is typical of Japan and China. In this policy, governments provide limited subsidies to private higher education institutions, where the tuition fees are high, but this aid is insufficient.

Finally, a high tuition/ high aid policy has appeared. This policy has two aims; to acquire excellent students and improve universities' finances. Under this policy, the net tuition fee of each student is different. The net tuition of each student is decided on the basis of need and/or merit in various systems depending on the policy of each university or college. As a result, net tuition, differentiated using these criteria, is discounted through the provision of these institutional grants. Universities and colleges can then attract more desirable students using this discount policy. Advocates of this policy argue that it is efficient because it is very different from the low tuition policy, which needs heavy public and/or institutional subsidies.

From the viewpoint of cost sharing, the four policies are very different. Public sharing is most common in low tuition/ high aid and the least common in high tuition/ low aid policies. In the middle comes the low tuition/ low aid policy. The cost sharing of a high tuition/ high aid policy is very different from these three policies, as cost sharing and net tuition fees vary from one student and/or parent group to another.

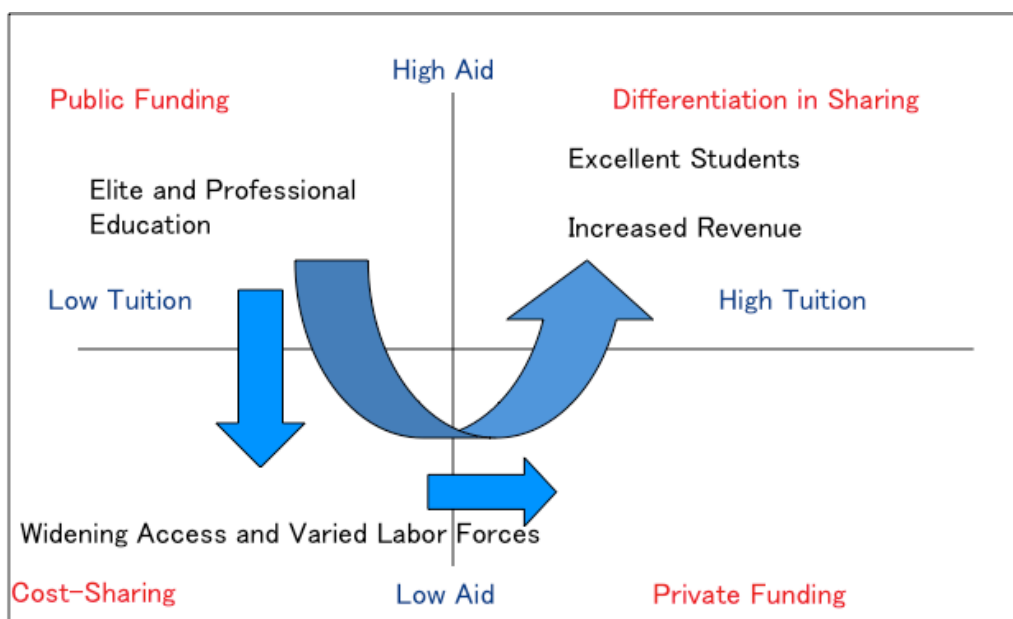
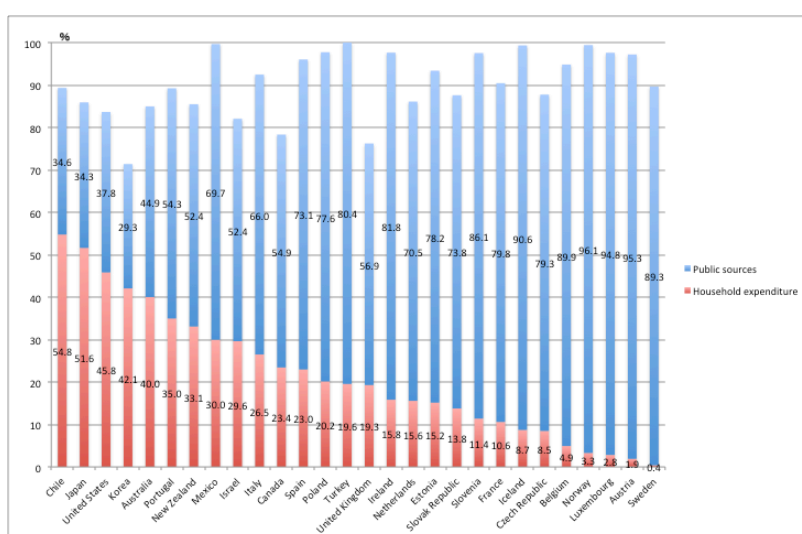


Figure 3 Factors behind the shift in tuition fees and student aid policy

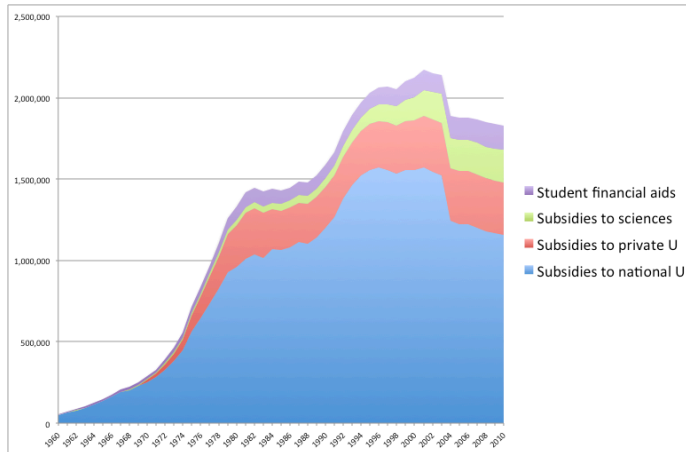
As for Japan, the parental burden of expenditure for tertiary education ranks highest in the world (Figure 4). The household share of higher education expenditure is more than half the total expenditure of higher education, and among the most expensive in the world, while public expenditure in tertiary education is the lowest among OECD countries. Should we or can we maintain this model of financing? The trend toward cost sharing in higher education seems to be shifting from public to private sources, such as to parents and the student themselves, but households already bear a heavy burden trying to pay for higher education.



Source: OECD, *Education at a Glance 2015*.

Figure 4 Public and household expenditure for tertiary education

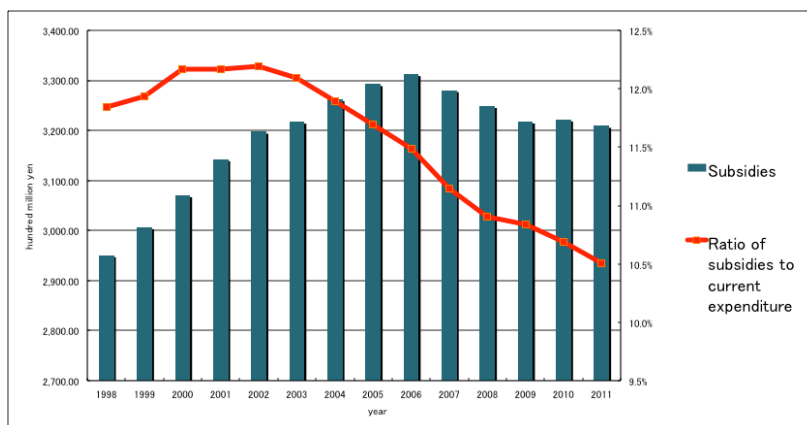
Also, the Japanese government's deficit has reached more than 960 trillion yen, which is more than any other developed country. Therefore, we do not expect government spending on higher education to increase in the future. As a matter of fact, government subsidies to universities have been stagnating (Figure 5).



Source: MEXT and MOF.

Figure 5 Changes in Government spending on higher education

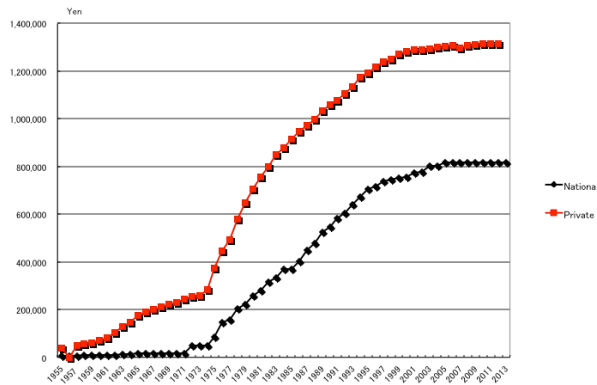
Government subsidies to national universities have been falling by one per cent a year since 2004. The amount was about 12.4 billion yen in 2004 but declined to about 11.4 billion yen in 2011. Figure 6 shows government subsidies to private universities and colleges. Both the amount and ratio of subsidies to current expenditure have been decreasing. In particular, one should note that the ratio has been rapidly decreasing to about 10.5 percent of current expenditure.



Source: MEXT.

Figure 6 Changes in Government subsidies to private universities and colleges.

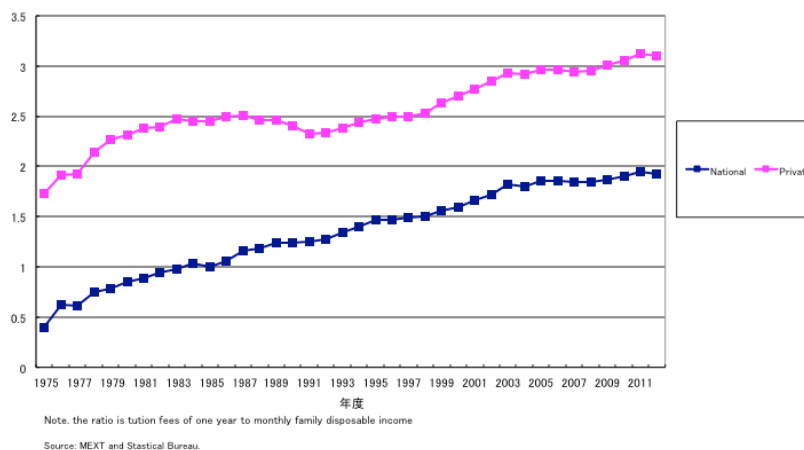
While subsidies to universities have been decreasing, the tuition fees both in national and private universities and colleges have been rising dramatically (Figure 7). The tuition fees charged by national universities in 2010 are more than forty times higher than in 1972, although the changes have been more modest in recent years. Adding to the fall in government subsidies, the increase in expenditure, such as on IT facilities, has forced most universities and colleges to raise their fees.



Source: MEXT.

Figure 7 Changes in average tuition fees (Current money)

Although the increase in tuition fees has been modest in recent years, families' disposable income has been decreasing. As can be seen in Figure 8, the ratio of tuition fees to family disposable income has been increasing gradually, which means the family burden with respect to higher education has been getting heavier and heavier.



Source: MEXT and Statistical Bureau "Household Survey."

Figure 8 The ratio of tuition fees to family disposable income

While the tuition fees of Japanese universities and colleges are very high, we have limited public grants and scholarships for undergraduate students both in the public sector and the private sector, except when it comes to tuition waivers. On the other hand, public student loans, in particular the student loans of JASSO (Japan Student Services Organization) have been increasing rapidly. Shibata's paper explains JASSO's student loans in detail. Here I underline that the Type II (low interest) loans introduced in 1984 have been increasing dramatically both for four-year and two-year undergraduate students. More than one in three undergraduate students have taken up these JASSO student loans. By contrast, the number of students who have received JASSO Type I (interest free) loans has been climbing very slowly (Figure 9).

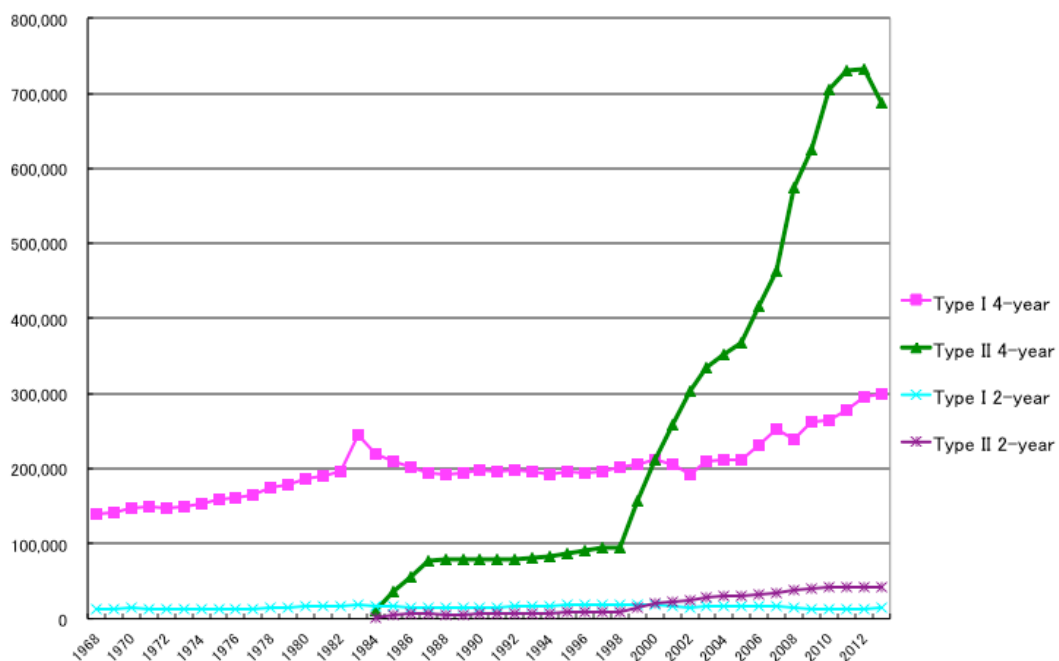


Figure 9 Changes in student numbers who have received JASSO student loans

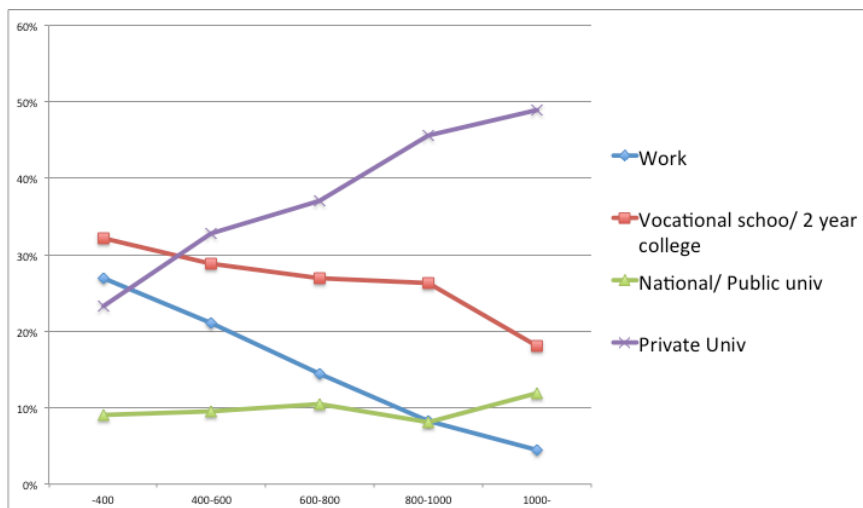
Thus, we have a serious dilemma between shrinking public support for higher education and a worsening family burden. Facing this serious situation, should we promote the shift of cost sharing from public to private further and, moreover, from parent to student? This is a very big social concern and an important policy issue.

3. Access to higher education in Japan

The rapid increase in tuition fees and the loan burden have seriously affected families with prospective university students by influencing their decision on whether or not to apply to university. This is born out by our 2006 nationwide survey of four thousand

groups of students and parents, which provides very strong evidence of inequality in higher education because of the differences in family incomes. The Survey Report has been published in Japanese by the Center for Research University Management and Policy at the University of Tokyo, which is led by Professor Kaneko, Motohisa.¹

Some results are included in our papers (Kobayashi 2008, Kobayashi and Liu 2014). The enrollment proportion of the lowest income class was only 35%, while that of the highest class was 61% (Figure 10). In particular, enrollment in private universities was highly correlated with income. However, this was not the case at national and public universities. National and public universities contributed to opening up higher education opportunities to all income groups, offering relatively inexpensive tuition fees compared to private universities. The resulting inequality has a strong influence on government policy, and there has been wide discussion on ways to ameliorate the situation. One option is to reform the student financial aid repayment scheme, which we will discuss later.



Source: CRUMP, High School Student Survey, 2006.

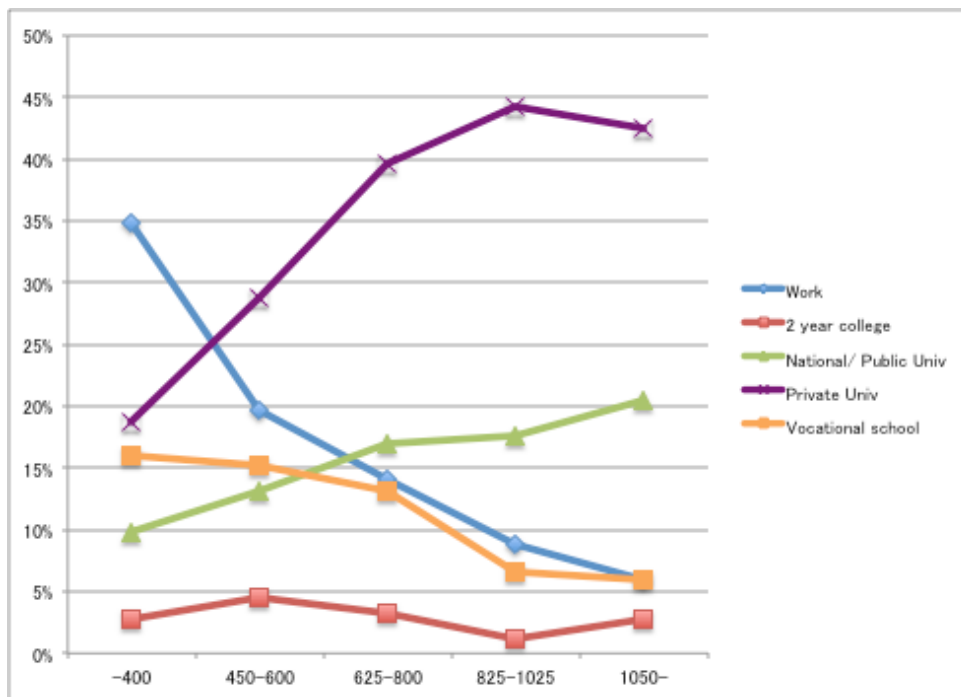
Figure 10 Destinations of high school leavers by income group, 2006

However, the situation has greatly changed for the parents of high school leavers in 2012. As shown in Figure 11, the enrollment rate in private universities is highly correlated with income, like in the 2006 survey, but the enrollment rate at national/ public

¹ This was a large nationwide random sampling survey of high school students and their parents, in Japan. Four thousand pairs of parents and their high school children were randomly chosen from 400 areas all over Japan. The first survey, interviewing parents and their children, was done in the fall of 2005. The follow-up survey for the children was done in the spring of 2006.

universities is now also strongly related to income, which was not seen in the 2006 survey. This heavy burden on the household has very serious effects on participation in higher education, especially for private four-year universities and colleges. One can see in Figure 11 that the enrollment rate of the children in the lowest income group is about 20 percent, while that of the highest income group is more than 40 percent in the Parent Survey of High School Leavers 2012. Therefore, we observe a disparity in enrollment rates between the two groups as having more than doubled. As for the enrollment rates at national and public universities and colleges, the enrollment ratios are 7.4% in the lowest group and 20.4% in the highest group. Therefore we observe the disparity in enrollment ratios is almost three times, which is worse than the case for private universities and colleges.

This is only one piece of evidence of a widening inequality in national and public universities, and we should conduct surveys to confirm this disparity. However, it is obvious that if this is the case, we should consider more effective student financial aid programs.



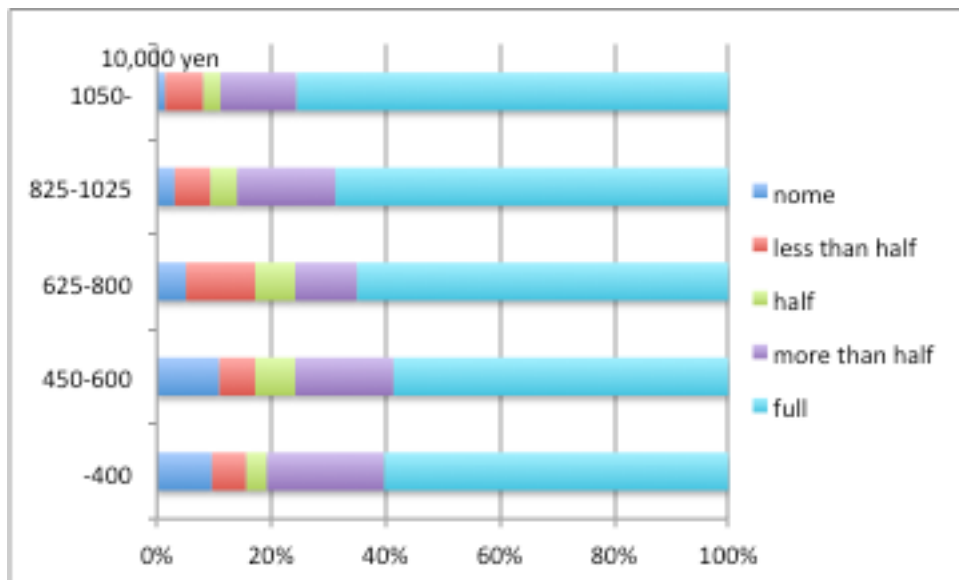
Source: Parents of High School Leavers Survey 2012.

Figure 11 Destinations of high School leavers by income group, 2012

4. Who should pay?

Despite the above inequality, we can observe from a global perspective that Japan had a

comparatively high enrollment ratio and comparative equality in access to higher education, as higher inequality in the private sector was balanced by equality in the public sector. This may be described as the “success” of Japanese higher education. We also found that this success is sustained by very strong parental willingness to pay for their children’s higher education, even among low-income families. Even the family of the lowest-income class has a very strong willingness to pay for their children’s education (Figure 10). Three out of four families of the highest income group (with an annual income of more than 10.5 million) pay all the living costs of their children’s attendance (excluding tuition fees), but more than half of the families of the lowest income group do the same thing, as is shown in Figure 12.



Source: Parents of Higher School Leavers Survey 2012.

Figure 12 Portion parents pay for the living costs of their children in higher education (excluding tuition fees)

It may seem ironic that parents’ willingness to pay for their children’s education hides this inequality in access to higher education, an inequality which would increase if parents did not pay. Parental behavior for the sake of their children reduces the political and social impact of educational inequality as an issue in Japan. In particular, enrollment ratios to university and college by income group are not correlated with income when their children’s academic achievement was in the highest group in the 2006 survey. The enrollment rate of the highest achievers of the lowest income group was 65% in 2006, while that of the children of the highest group was 71%. This proves that even the lowest income families paid their children’s educational expenditure, meanwhile sacrificing their

living standards if the children are higher achievers.

However, this pattern of enrollment for the highest achievers of the lowest income group changed a little in our 2012 Survey. The enrollment rate of the highest achievers of the lowest income group is 57%, while that of the highest income group is 77%. Thus the difficulty in enrolling in higher education for children of the lowest income group has been increasing. This is the situation we have to consider when we discuss student financial aid in Japan.

5. Student loan schemes and debt problems

As tuition fees increase, the burden on the family to pay the cost of higher education is heavier, and more families take out student loans. However, some families do not use the loans because the debt is so heavy that their children must repay the debt after graduation. This is called debt aversion or loan aversion. This phenomenon is widely seen in various countries. It is a very serious problem, because the purpose of student loans is to reduce the burden on a family to pay for higher education, and we cannot accomplish this purpose if this is the case.

To solve this serious problem, reform of the student loan repayment scheme has been advocated. ICR is one scheme that could solve this problem because it is similar to a kind of “insurance.”

Another problem with student repayment is that some borrowers default. How can we reduce the number of defaults? In Japan, this number has been increasing. The reasons for this increase are, one, bigger student loans for low achievers, which places a heavy loan burden on low-income borrowers, two, weak penalties, and, three, an unwillingness to pay. From the point of view of collecting a loan, it is very important to distinguish between an unwillingness to pay and an inability to pay.

Income contingent repayments (ICRs) have been introduced in some countries for this purpose. One important point is the interest on ICRs. ICRs in some countries, such as Australia and the UK, are interest free, but in the US the interest rates are high, and the loan repayment period is longer than is the case for other repayment plans. Therefore the total amount of repayed ICR is higher than it is for the other plans. So ICRs are not popular in the US. This shows the key determinant for introducing ICRs is who bears the interest rates.

6. Access, the information gap and financial literacy

What creates the difference in enrollment in higher education by income group? The financial burden of higher education expenditure is a serious cause, as we have discussed. Recently another cause has been the focus of research in various countries. This is the so-called *information gap*. Low income families do not have enough information on the

costs and benefits of higher education. Most of them are not familiar with financial options such as loans. Besides some of them do not know that they are eligible for student grants or scholarships. They have limited resources to gather information and often do not have family members who have any experience of attending higher education.

Some governments have attempted to improve this situation. For example, in the Widening Participation program in the UK, the government and Student Loans Company disseminate information on the costs of higher education. In the United States, some initiatives to improve the information gap among students have been tried. Two of these are “School Score Card” and “Shopping Sheet.” In this report, some examples will be discussed.

7. The Current Situation in Some Countries

Before the detailed discussion of the situation in each country’s situation in the chapters that follow, readers may find it useful to receive a rough outline of what is happening in some of them.

1. England

Tuition fees and student financial aid policy have been drastically changed in England. Before 1997, universities did not charge any fees, but tuition fees of 1,000 pounds were partly introduced in 1998. Not all students were charged 1,000 pounds, and there still remained free tuition for students from low income families. At the same time, the income contingent loan was introduced and grants for undergraduate students were abolished. This was a very drastic reform in the history of English universities.

Then there came another huge change, the 2006 Reform. In this reform, each university could charge a so-called “top-up fee” of up to 3,000 pounds. Most universities raised their tuition fees to the maximum 3,000 pounds. At the same time, each university has an obligation to give bursaries to students, in particular, to students from low income families. The tuition fees and other details of student financial aid must be determined by a contract called an “Access Agreement” with a new established Office for Fair Access (OFFA). This was introduced to mitigate the worst effects from having raised tuition fees by 300%. Students pay their fees after graduation with income contingent loans. The pros and cons of this reform will be discussed in Nicholas Barr’s paper.

First, he sets out the three objectives of higher education policy: (a) strengthening the quality of teaching and research, (b) improving access for students from disadvantaged backgrounds and (c) ensuring that the system is large enough to accommodate all qualified applicants.

Second, he sets out four key lessons from economic theory: (a) that graduates should

share in the costs of their degree (b) well-designed student loans should have income-contingent repayments (i.e. repayments in the form of x% of the borrower's subsequent earnings) (c) competition between universities helps students, and (d) government has a wide-ranging and continuing role.

Third, he sets out a strong finding that, provided a good loan system is in place, the main impediment to access is a lack of good high school graduation grades.

Fourth, he discusses reforms of higher education finance in England in 2006, arguing that the reforms had quantifiable benefits. He argues that the direction of the 2006 reform was almost right. There is no expenditure for a family and student during their school days. After graduation, they can repay the tuition fees according to their income. Thus it is a very rational and effective way of cost-sharing.

He argues, however, that the recent 2012 Reform of tuition fees and student grants and loans has had serious and deleterious effects. His explanation is very clear and sophisticated. Finally, he considers a potential reform strategy for Japan, while also discussing the underlying philosophy of student loans. We will discuss his lessons for student financial aid policy in Japan in the concluding chapter.

2. The United States of America

The most distinguishing characteristics of American higher education are its diversity and dynamism. The American higher education system consists of four major groups: four-year public universities and colleges, four-year private not-for-profit universities and colleges, two-year public community colleges, and for-profit institutions. Four-year universities and colleges are sub-grouped into research universities and colleges (doctoral), comprehensive universities and colleges (master), and liberal arts colleges. Thus, various types of higher education institutions coexist in American higher education.

The student financial aid system is also diversified and highly complicated. For example, federal student financial aid programs have several types of federal student grants, student loans, and campus work study programs. Each state government has its own student financial aid programs. In addition, there is "institutional aid", where a higher education institution gives its students grants or scholarships.

One recent notable trend in higher education in America is that many universities and colleges have been introducing a "high tuition and high aid policy", as was discussed in the previous section. On the one hand, tuition costs and fees have been rising dramatically. On the other hand, various forms of student financial aid have been increasing as the tuition and fees have been rising. Nonetheless, from the viewpoint of cost-sharing, the payment of higher education costs has been shifting from public funding to families and students.

Prof. Laura Perna argues that, as the responsibility for paying college costs has shifted from governments to students and their families, student loans have become an increasingly common type of financial assistance in nations across the globe. She offers insights for Japanese policy makers, drawing from what is known about student financial assistance in the United States.

Her paper is organized to address the following questions:

1. Why do students in the U.S. use loans to pay college costs?
2. What are the primary concerns about the use of student loans in the U.S.?
3. What are government policies for addressing these concerns?
4. What are the relevant insights for future Japanese policymaking?

3. China

In China, higher education was developing rather slowly until 1991. However the gross enrollment rate has been greatly increasing since then. Before 1999, the rate was below 10%, but quickly reached 15.0% in 2002, and 40.0% in 2015.

This expansion in higher education has mainly been sustained by public universities and colleges, but one can also see a rapid increase in private higher education institutions. The share of the public sector is over 70%.

As higher education has grown, tuition fees have been climbing to as high as about 6,000 Chinese Yuan. Most student financial aid programs have been merit-based and only a small number of students were recipients until 1999. Therefore, the burden of higher education costs was heavy in particular for low income families. Then the government embarked on reform of the student financial aid programs. New need-based student financial aid programs were introduced in the 2000's. There are now several needs-based student financial aid programs, alongside the merit-based ones. The government has introduced two new student loan programs, too. One of them is the home-based student loan program. Here "home" means the homeland of the student and family. Traditionally, Chinese students and their families have a strong relationship with their homeland. In this loan program, students and their families are co-borrowers. This is a unique characteristics of this student loan program. County-level student financial assistance management centers are mainly responsible for the collection of these loans, but the government bears the entire risk for the compensation fund.

After an overview of China's higher education and student financial aid schemes, Professor Wei Jianguo argues thaty this new student loan program is successful. The share of the recipients of this loan is over 80%, but the default rate was below 3% in 2012.

Then he explains his cluster-randomized controlled trial to find the causal relationship

between information regarding college costs and student financial aid and some related outcomes. He found that students' knowledge of student financial aid programs was relatively low, but there was no evidence that college costs and financial aid information affects college choice. However, such information definitely affects the likelihood of non-admitted students retaking the college entrance examination and receiving certain types of financial aid.

Finally, he argues that the problem of the information gap has been greatly improved by recent governmental initiatives.

4. Japan

As I have already mentioned, the share of higher education costs in Japan is the highest among developed countries. In particular, tuition fees are very high at private higher education institutions, while at national and public universities and colleges they have been dramatically increasing at a more and more rapid pace since 1972.

However, the student financial aid scheme has not changed dynamically in Japan. The Japan Student Services Organization (JASSO) has been the largest provider of student loans. In Japan, they have a tuition waiving scheme, especially for national and public universities and colleges, but there is a shortage of public grants for undergraduate students. JASSO and the Ministry of Education (MEXT) say that JASSO has two types of student loan programs. One of them is an interest-free type, which means that the government subsidizes this program. These subsidies are not indexed to inflation, so they are completely interest-free (zero interest rate). This is the unique characteristics of this loan program, and makes it different from Australia's HECS, which is an interest-free program but the loans are indexed to inflation. Therefore, in reality, the interest is linked and charged according to inflation in HECS.

Because of this unique characteristic of the JASSO loan program, it is called a "scholarship loan." Actually, JASSO is the successor of the Japan Scholarship Foundation, which was established in 1943 and provided interest free student loans from 1944.

Although the interest-free loan is a unique characteristics of the student loan program in Japan, the other type of JASSO student "scholarship loan" is being increasingly used and this trend is accelerating. Although the interest rate on this loan is below 2% at present, it has a cap of 3%, and this low interest loan has been the main student loan in Japan up to now.

In 2012, JASSO introduced an income contingent loan repayment (ICR) scheme for an interest-free loan program, but this ICR is very limited. Eligible borrowers are restricted to low income families with an annual income of below three million yen. The repayment of the loan is deferred when the income of the borrowers is below three

million yen, but they should repay the total amount as soon as their income is over three million yen, which introduces the problem of “cliff effects.”

Shibata concisely explains the history and unique characteristics of JASSO’s “scholarship loan” and the reason why the low-interest loan program is increasingly being used instead of the interest-free loan program. According to him, the main reason for the increase in the low-interest loan program was that the government was looking for new investment fields for its fiscal loans funds after a review of its traditional areas of expenditure, like public works. Then he presents an overview of the present situation of JASSO’s “scholarship loan”.

His main research question is the following: the growth of the low-interest loan program has been sustained by the very low interest rate in Japan, but is it possible to sustain this low-interest loan program in the face of declining public support?

He then compares the present JASSO ICR with the British one, and proposes the introduction of the British scheme.

5. Comments

After the four papers on the situation in four countries, Yoshitaka Hamanaka made comments at the international symposium. We include his comments in this report.

He explains the characteristics of Japan’s Student Financial Aid through its unique historical background. He then submits that current issues are deeply rooted in the traditional philosophy of higher education and student financial aid in Japan. Finally, he suggests the introduction of income contingent loan programs. His main concern is the quality of higher education as well as the tuition and student financial aid programs.

We will discuss these questions and issues in the final chapter of this report, while summing up the lessons for the student financial aid scheme in Japan and the suggestions made in each paper and the comments. We believe this is a very fruitful approach when it comes to considering the future of student financial aid schemes not only in Japan but also in other countries.

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Chapter 2

Financing Higher Education:

Theory, International Evidence and UK Experience

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Chapter 2 Financing Higher Education: Theory, International Evidence and UK Experience²

Nicholas Barr³

Abstract

The initial section sets out the objectives of higher education policy, in particular (a) strengthening the quality of teaching and research, (b) improving access for students from disadvantaged backgrounds and (c) ensuring that the system is large enough to accommodate all qualified applicants.

The second section sets out four key lessons from economic theory: that graduates should share in the costs of their degree; that well-designed student loans should have income-contingent repayments (i.e. repayments in the form of $x\%$ of the borrower's subsequent earnings); that competition between universities helps students; and that government has a wide-ranging and continuing role.

The third section sets out a strong finding that provided a good loan system is in place, the main impediment to access is a lack of good high school graduation grades.

The fourth section discusses reforms of higher education finance in England in 2006, arguing that the reforms had quantifiable benefits. The fifth section sets out the less satisfactory results of reforms in 2012.

The final section considers a potential reform strategy for Japan, including discussion of the underlying philosophy of student loans.

1. Introduction

Higher education finance in England has seen considerable change.

² This is a revised version of a paper originally published in CESifo DICE Report 2/2012, pp. 56-62. Fuller discussion can be found in Barr (2012a).

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- In 1990, the government introduced loans with fixed monthly repayments to supplement tax-financed grants to cover living costs.
- Reform in 1998, following the Dearing Report (National Committee of Inquiry into Higher Education, 1997), introduced annual tuition fees of £1,000 and loans with income-contingent repayments (i.e. repayments calculated as x per cent of the borrower's subsequent income, collected alongside income tax) to cover living costs but not fees.
- Reform in 2006 introduced variable fees of up to £3,000 but, importantly, covered by a loan, so that nobody had to pay upfront charges (for assessments *ex ante* and *ex post*, see Barr 2004, 2012a).
- Reforms in 2012 raised the maximum fee to £9,000, made changes to the design of the student loan, withdrew most taxpayer support for teaching in the arts, humanities and the social sciences, and abolished Education Maintenance Allowances and AimHigher targeted at disadvantaged schoolchildren.

Higher education matters for the transmission of knowledge and skills, the promotion of core values and the pursuit of knowledge for its own sake. More recently, it has come to matter also for national economic competitiveness and for individual life chances. This article considers the design of higher education finance in pursuit of three specific objectives:

- Quality: strengthening the quality of teaching and research;
- Access: raising the participation by students from disadvantaged backgrounds; and
- Size, i.e. ensuring the sector is large enough so that all qualified applicants can find a place.

The first two objectives are widely accepted. The third is often overlooked. Size is relevant both to national economic competitiveness and to social mobility. Implicit in these objectives are several value judgements: that higher education has intrinsic value; that national economic performance matters; and that widening participation is important.

2. Lessons from economic theory⁴

Lesson 1: Graduates should contribute to the cost of their degree. Higher education creates social benefits above those to the individual, including the transmission of values, social and political engagement, and economic growth, justifying continuing taxpayer subsidies. That these are difficult to quantify does not invalidate the argument. But

⁴ For fuller discussion, see Barr 2012b, Ch. 12.

graduates also receive private benefits, including higher average earnings and (often overlooked) more enjoyable jobs. It is therefore both efficient and equitable that the beneficiaries should bear some of the costs. However, students are credit constrained. Efficient consumption smoothing suggests that they should bear those costs when they can afford them, as graduates. This leads directly to the second set of lessons.

Lesson 2: Well-designed student loans have core characteristics. Loans should have income-contingent repayments. The original argument was set out by Friedman (1955; on why loans rather than a graduate tax, see Barr 2012b, p. 331), who noted that borrowing to finance investment in human capital, in contrast with a home loan, offers no physical collateral. Thus lenders charge a high risk premium, and borrowers also face considerable risk, leading to sub-optimal investment in human capital. Income-contingent repayments protect borrowers from excessive risk, and collection via the tax system reduces the risk to lenders of making an unsecured loan.

Additionally, loans should be large enough to cover fees and realistic living costs, thus addressing credit constraints and assisting access by making higher education free at the point of use. We return to this point in section 6.1 which discusses the different philosophies that can underlie student loans.

A third feature is that loans should charge an interest rate related to the government's cost of borrowing. Until 2012, the UK, like some other countries, charged a zero real interest rate. Since that is less than it costs the government to borrow the money, loans include a blanket interest subsidy – in present value terms not even the best-off graduates repay their loan in full. If, as in the UK, loans have (a) income-contingent repayments and (b) forgiveness of any balance unpaid after 25 years, interest subsidies are unambiguously bad design.

Since the argument about blanket interest subsidies is central to assessment of the 2012 reforms it is worth amplifying. First, the subsidy is expensive. In the UK, nearly one-third of all lending to students never comes back simply because of the interest subsidy. Second, because of the resulting fiscal cost, loans are too small, harming access. Third, the subsidies crowd out university income, putting quality at risk and, more recently, leading to a cap on student numbers, hence a shortage of university places. Finally – and counterintuitively – the subsidies are regressive. Graduates with low monthly earnings are protected by income-contingent repayments, and those with low lifetime earnings by forgiveness after 30 years. Interest subsidies do not help high-earning graduates early in their careers: with income-contingent loans, monthly repayments depend only on earnings; interest rates affect only the duration of the loan. Thus the major beneficiaries are successful professionals in mid career, whose loan repayments are switched off earlier because of the subsidy than would otherwise be the case. Shen and Ziderman (2009) give

an international perspective on the high cost and bad targeting of blanket interest subsidies

Lesson 3: Competition is beneficial. In many countries, higher education has been centrally planned. With the sharp increase in the range of subjects taught, central planning is no longer feasible or desirable. The argument has its roots in the economics of information. Students (in contrast with school children or people with complex medical problems) are well-informed, or potentially well-informed, and hence better able than planners to make choices which conform with their interests and those of the economy. An important exception concerns people from poorer backgrounds, with implications, discussed below, for the design of policies to widen participation.

Lesson 4: Government has an important continuing role. The argument for competition does not negate a continuing role for government (Barr, 2012b, section 12.4.5). Government should provide continuing taxpayer support to higher education; ensure that there is a good loan system; adopt, encourage and mandate policies to widen participation; regulate the system, for example ensuring that there is effective quality assurance; set incentives by offering larger subsidies for subjects the government wishes to favour, and larger subsidies for some students; and redistribute within higher education.

3. Evidence on the determinants of participation

The evidence points to two central drivers of participation: credit constraints, and constraints with earlier roots (for fuller discussion, see Barr 2012b, section 12.4.4).

The primary role of student loans is to provide consumption smoothing in the face of credit constraints. Though the UK has had income-contingent loans since 1998, discussion continues to conflate credit-card debt, which is unforgiving, with student loans, which are a payroll deduction (Table 1).

Table 1 Student loan repayments, UK 2015-16

| | | | | |
|-----------------------------------|---------|---------|---------|---------|
| Annual earnings | £21,000 | £25,000 | £30,000 | £50,000 |
| Income tax (monthly) | £173 | £240 | £323 | £784 |
| National Insurance (NI) (monthly) | £129 | £169 | £219 | £356 |
| Total income tax and NI (monthly) | £302 | £409 | £542 | £1,140 |
| Loan repayments (monthly) | £0 | £30 | £87.50 | £217.50 |

Notes: income tax and national insurance contributions are calculated from www.moneysavingexpert.com/tax-calculator/. Loan repayments are calculated from the loan repayment formula (9% of income above £21,000 per year).

Constraints with earlier roots arise in several ways, largely manifesting themselves in poor school grades. In 2002, when students from poor backgrounds paid no tuition fees, 81 per cent of children from professional backgrounds in England went to university; the comparable figure for children from manual backgrounds was 15 per cent (Education and Skills Select Committee, 2002, p. 19). However, about 90 per cent of students with good high school graduation grades went to university, irrespective of their background. In other words, controlling for attainment, the socioeconomic gradient in participation largely disappears (for fuller discussion, see Chowdry *et al.* 2013) .

Many commentators argue that ‘debt aversion’ harms access, but studies are frequently flawed because they fail to control for attainment, and thus wrongly attribute to the credit constraint problems that have their roots in the attainment constraint.

4. The 2006 reforms in England

1. The reforms

The 2006 reforms were based explicitly on the theory and empirical evidence in section 2.⁵

Fees. Instead of the previous fixed tuition charge of £1,000, universities could choose what fee to charge up to £3,000 per year.

Loans. The 1998 system provided an income-contingent loan to cover living costs, but with no loan to cover fees. The 2006 reforms introduced a loan to cover fees. Loans for fees and living costs charged an interest rate equal to the rate of inflation, so the system incorporated an interest subsidy for all graduates.⁶ Any loan unpaid after 25 years is forgiven.

Policies to widen participation. The 2006 reforms restored tax-financed grants, required universities that charged £3,000 to provide students from poor backgrounds with

⁵ See Barr (2012a). In a comprehensive OECD study, Santiago et al. (2008) reach the same conclusion.

⁶ The arguments against blanket interest subsidies were understood and accepted by government. The decision to retain interest subsidies was based on the political calculation that otherwise the proposal would be rejected. That reading was correct: in the key Parliamentary vote, at a time when the Blair government had a majority of 160, the legislation passed by 5 votes.

financial assistance, and established an Office for Fair Access.

Crucially, other reforms tackled inequalities earlier in the system.

- Policies targeting early childhood included Sure-Start, which provided child care and training for mothers on low incomes; a National Child Care Strategy made affordable child care more available; and nursery school and pre-school places were increased.
- Increased emphasis on basic skills included a Literacy Hour and Numeracy Hour.
- Education Maintenance Allowances provided financial support for students from poor families from age 16 to encourage them to stay at school.
- AimHigher sought to improve the information of schoolchildren and to raise aspirations.

2. Outcomes

Notwithstanding widespread misgivings at the time, the 2006 reforms had beneficial effects. Between 2006 and 2012 income from tuition fees increased by 87 per cent and student numbers by 20 per cent. In addition, participation improved sharply: between 2006 and 2012, the number of applicants from the most disadvantaged backgrounds increased by over 50 per cent.

The Higher Education Funding Council for England (2013) investigated participation by the most disadvantaged quintile: young people living in areas with the lowest participation rates and find that,

‘The young participation rate ... increased over the period, from 13 per cent for the 98:99 cohort to 20 per cent for 11:12 cohort, representing a proportional increase of +52 per cent. However this increase in participation has not been evenly distributed across the period; there was a much larger increase during the second half of the study period, where participation rates increased by six percentage points, compared with the first half, where participation rates increased by one percentage point.’ (para. 38)

An earlier study (Higher Education Funding Council for England 2010) had tested earlier similar findings:

‘Trends in social statistics – such as HE participation rates – that are associated with deeply rooted differences in advantage do not usually show rapid change. A set of robustness and credibility checks give confidence that the analysis in this report is faithfully describing HE participation trends. In particular, the unusually rapid increases in HE participation recorded since the mid-2000s for young people living in disadvantaged areas *are supported by changes in the GCSE attainment* [public exams at around age 16] of

the matching cohorts of young people' (para. 31, emphasis added).

5. The 2012 reforms in England

1. The reforms

The 2012 reforms were based on coalition politics and lacked strategic coherence (for further detail, see Barr 2012a).

Fees. The reforms abolished taxpayer support for teaching in the arts, humanities and the social sciences. Partly as a result, the fees cap was raised from £3,000 to £9,000.

Loans. The reforms introduce a real interest rate, in most cases 2.2 per cent, broadly the government's long-run cost of borrowing. Nevertheless, loans continue to be expensive for two reasons discussed below: the level of income at which graduates start to repay is too high; in addition, universities had an incentive to charge £9,000, since the costs of non-repayment of loans falls not on the university but on taxpayers.

Participation. As discussed below, action to widen participation was negative.

The rest of this section evaluates the resulting system (for fuller discussion, see Barr 2012a). The good elements are the increase in the fees cap; the increase in the interest rate on loans; improving information for prospective students; and improved support for part-time study. The bad elements are the withdrawal of taxpayer support for teaching; the large increase in the loan repayment threshold, leading to a cap on student numbers; and the retrograde steps in policies to widen participation.

2. Progress

Raising the fees cap. From 2012, universities can charge up to £9,000. Two questions arise: should there be a fees cap; and, if so, is it right to increase it?

The case for variable fees is that they (a) bring in additional resources and (b) in combination with robust quality assurance, strengthen competitive incentives to use those resources efficiently. The argument for some form of regulation of fees is that though universities compete in terms of teaching, some are also selling access to the student's network of peers. Thus they are selling a positional good, giving them an element of monopoly power which, it can be argued, partly explains the very high level of fees at some US universities.

Why, then, is it right to increase fees? The cap of £3,000 was too low: it brought in additional resources but not enough, and produced no variation in price, muting competitive incentives. However, the increase is too large because of the mistaken abolition of taxpayer support for teaching in most subjects.

Increasing the interest rate on student loans. From 2012, the default real interest rate

on student loans was raised to 2.2 per cent, broadly the government's cost of borrowing over the long run.

Improved support for part-time study. The reforms make fees loans available to students studying at least 25 per cent of full time. Widening part-time options assists participation by offering students a low-cost experiment. Someone who is uncertain might not take the risk of full-time study. The option to dip one's toe in the water (evening or online study) assists participation.

3. Regress

Abolishing taxpayer support for teaching. The reforms largely replace taxpayer support for teaching (known as the T grant) of the arts, humanities and social sciences by a larger loan entitlement.

The policy is mistaken because it ignores the public benefits of higher education. Without a subsidy, demand will be below its efficient level: if universities increase fees by the full amount of lost subsidy, too few students will apply; if universities do not increase fees to cover lost subsidy, the risk is an inefficient reduction in quality.

A major driver for this policy is that replacing T grant by loans reduces the budget deficit as measured by the Public Sector Borrowing Requirement (PSBR). Suppose that it is estimated that in present value terms 30 per cent of student loans are not repaid. If total lending is £4 billion, £2.8 billion, the part that will be repaid, is excluded from measured public spending. Only the estimated non-repayment of £1.2 billion is included.

Thus replacing T grant of £4,000 per student by a loan has the following effect.

- A million students each attracting a T grant of £4,000 increases PSBR by £4 billion.
- A loan of £4,000 for a million students increases PSBR by £1.2 billion.

Thus replacing T grant by an equal loan entitlement reduces PSBR by £2.8 billion. The main motive for replacing T grant by loans is an accounting trick. There is an apparent decline in public spending, but at the cost of distorting higher education policy.

Raising the threshold at which loan repayments start. Under the 2006 arrangements, graduates repay 9% of income above £15,000 per year. Under the 2012 reforms, the repayment threshold is increased to £21,000 and is indexed to earnings. Any loan balance that remains outstanding after 30 years will be forgiven.

The higher threshold has profound ill-effects. The change is expensive because it reduces monthly repayments for everyone including the highest earners. With lower monthly repayments, more graduates will not repay in full within 30 years. Thus student loans are fiscally expensive, hence there is an incentive to government to cap student numbers.

The main reason for the policy was to give the political appearance of progressivity. The reality is that increasing the repayment threshold (a) gives least benefit to low earners, (b) is expensive, and hence (c) leads to restriction of student numbers. Indexing the threshold to earnings locks in this regressive pattern.

Adverse effects on participation. Earlier discussion stressed the importance of prior attainment, and pointed to the improvements that followed the 2006 reforms. The 2012 changes are deeply retrograde.

The reforms abolish Education Maintenance Allowances and AimHigher and make cuts to SureStart – the very policies which address problems of participation at their source.

A second problem, excessive focus on grants (i.e. non-repayable support), to a significant extent targets resources at the wrong part of the problem. The error is not just an exercise in academic logic chopping. In failing to distinguish credit constraints and constraints with earlier roots, policy is based on the wrong diagnosis and therefore leads to the wrong prescription. It spends money on ‘free’ higher education rather than on addressing the constraints on participation that arise much earlier, and thus spends money on a policy that does not work.

4. Conclusion

In the 2006 system the interest subsidy made loans fiscally expensive. The reforms rectify that problem but loans continue to be fiscally expensive because of the large increase in the repayment threshold. Thus the new system creates the same problem – the cap on student numbers – for the same reason – the high cost of loans.

In sum, the reforms are (a) expensive, (b) restrict student numbers and (c) weaken the policies that widen participation. They will not stand the test of time. The resources currently spent on a fiscally incontinent loan system should be diverted to restoring some taxpayer support for teaching, adjusting the design of the loan system so as to relax the constraint on student numbers, and strengthening policies to widen participation (for fuller discussion, see Barr 2015).

6. Some implications for Japan

1. What is the underlying purpose of student loans?

There are different ways of thinking about student loans:

- As a safety net, i.e. a device for poverty relief; or
- As a device for consumption smoothing.

To date, the Japan has seen student loans as a safety net and has therefore sought to target loans on students from poor backgrounds. It can be argued that that approach was

the right one in an era when higher education was mainly a consumption good for the intellectual middle class. In that world, loans were more an equity than an efficiency device.

That, however, is yesterday's world. Skill-biased technological skills has driven up the demand for skills. Human capital has become increasingly important – countries cannot afford to waste talent. Thus higher education is necessary both for reasons of national economic performance and to increase individual life chances.

The growing importance of human capital has a fundamental bearing on the purpose of student loans: they exist not only to help the poor but to facilitate investment in human capital more generally. Thus in principle everyone should be eligible for a full loan, i.e. loans are not targeted. The economic principles underlying this approach are set out earlier in this paper (see economic theory lesson 1): taxpayer subsidy should reflect the public benefits engendered by higher education, and the individual beneficiary should pay for his or her private benefits.

However, students (the individual beneficiaries) are generally poor in terms of current earnings, even if rich on a lifetime basis, i.e. students are credit constrained. The purpose of loans is to relieve those credit constraints by making higher education free for students, enabling them to pay for their private benefits when they can afford it, i.e. as graduates rather than students. Thus loans are a device for consumption smoothing.

However, borrowing to finance a degree is risky because there is no physical collateral, so efficient consumption smoothing requires an element of insurance. That is the purpose of (and importance of) the income-contingent design discussed in lesson 2. As noted, in the UK income-contingent repayments provide insurance against low current earnings and write-off after 30 years insurance against low lifetime earnings. But (a) it remains the case that loans are primarily a device for consumption smoothing and (b) resources to widen participation are more effective when spent earlier in the education system (Chowdry et al. 2013) than on subsidising loans. Thus, except for the insurance element, a well-designed loan should be broadly self-financing in present value terms, thus releasing resources better used for widening participation, improving quality, and expanding the system.

The resulting policy can usefully be thought of as having two elements:

- A standard policy of tuition fees financed by income-contingent loans for 'easy' cases, i.e. students from middle-class backgrounds.
- Targeted policies for more difficult cases, notably students from poorer backgrounds, to widen participation. Such policies will have a significant focus on interventions earlier in the education system.

2. Implications

The analysis in section 2 leads to a strategy with three elements that is relevant to Japan:

- Element 1: quality and size: universities should be financed from a mix of taxation and tuition fees (economic theory lesson 1). Fees give institutions more resources and, through competition (lesson 3) supported by quality assurance (lesson 4), help to improve the efficiency with which those resources are used. However, students generally cannot afford to pay fees or living costs, hence:
- Element 2: loans to address credit constraints: loans with income-contingent repayments should be large enough to make higher education free at the point of use (lesson 2). Such loans fix problems of participation for well-informed students with good school attainment. If the world comprised only such students, the strategy would end there.
- Element 3: policies to address constraints with earlier roots, notably lack of attainment, imperfect information and low aspirations.

To achieve multiple objectives, policy needs multiple instruments. The specific argument is that tuition fees *combined with* policies to address credit constraints and earlier constraints on participation address all three of quality, access and size.⁷ The error often made in newspaper articles is to consider tuition fees on their own without controlling for other relevant variables such as the availability of loans, policies to increase prior attainment, etc.

Tuition fees alone (element 1) will reduce demand and harm participation; and tuition fees plus financial support (elements 1 and 2) address only some of the impediments to participation. A considerable literature (e.g. Dynarski 2002, 2003; Long 2007, 2010; Dearden et al. 2011; see also Perna and Ruiz 2015) considers fees and financial support, and is sometimes wrongly interpreted as showing the ill-effects of fees. Its real importance is that it shows the effect of credit constraints, either because there is too little financial support and/or because complexity reduces the effectiveness of financial support. To the extent that lack of prior attainment, imperfect information and low aspirations are additional major constraints, it should not be surprising that evidence on the influence on participation of college aid *per se* is equivocal.

⁷ In terms of economic theory these elements are very familiar: higher fees move people back up their demand curve; the pro-access policies shift the demand curve of people from disadvantaged backgrounds outwards.

A more complete treatment needs to consider the full range of constraints.

Paradoxically, it is not only tuition fees that harm participation but also their absence. McKay and Rowlingson (2011, p. 110) cite Tilly's (1998) argument 'that groups with power try to retain the best opportunities for themselves in what he calls "opportunity hoarding"'. Tuition fees on their own do that, but so does tax finance beyond that commensurate with public benefits and addressing risk aversion rooted in imperfect information. There are at least three arguments. First, though tax finance on a sufficient scale can address credit constraints, it does nothing to address the other constraints. Tax-financed higher education, the system in Britain for over 40 years, produced the shameful participation figures discussed in section 3.

Second, over the past 25 years, higher education in almost all OECD countries has increasingly lost in the political competition for public resources. The resulting shortage of resources constrains size, and hence access, if student numbers are capped, and harms quality if they are not.

Third, tax finance has powerful redistributive effects. There is, of course, no such thing as 'free' higher education. Free is just another word for 'someone else pays', so the right question to ask is who pays. Part of the case for public finance of health care or compulsory school education is that everyone uses them. Higher education is different: participation is a matter of choice – and it is mainly people from better-off backgrounds who participate. Thus the taxes of poorer people, many of whom never even considered completing high school⁸, pay for the degrees of people mainly from better-off backgrounds. Thus taxation (a) finances an activity consumed mainly by the better off, which (b) helps to maintain their position among the better off, while (c) simultaneously harming access through a shortage of places and by crowding out activities that genuinely widen participation. A clearer example of opportunity hoarding would be hard to find.

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⁸ 68% of 19-year olds applying to university in 2011 had parents with a degree, compared with 28% for those with parents educated who did not complete high school (Department for Education, 2011, Chart 2.1.2).

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Chapter 3

The Use of Loans to Pay College Costs: Insights from the U.S.

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Chapter 3 The Use of Loans to Pay College Costs: Insights from the U.S.

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Abstract

As the responsibility for paying college costs has shifted from governments to students and their families, student loans have become an increasingly common type of financial assistance in nations across the globe. This paper offers insights for Japanese policymakers, drawing from what is known about student financial assistance in the United States.

The paper is organized to address the following questions:

1. Why do students in the U.S. use loans to pay college costs?
2. What are the primary concerns about the use of student loans in the U.S.?
3. What are government policies for addressing these concerns?
4. What are relevant insights for future Japanese policymaking?

The transferability of the insights identified in this paper to Japan is limited by the many differences in the economic, political, historical, and demographic contexts of the U.S. and Japan, as well as the differences in the higher education systems of the two nations. Nonetheless, this consideration of the concerns about loans and related government policies in the U.S. suggests the following insights for Japanese policymakers:

1. Consider how the costs of higher education should be shared among relevant stakeholders and adopt policies that achieve this cost-sharing;
2. Adopt policies that reduce the need for borrowing, especially for students most at risk for not completing their degree programs;
3. Adopt policies that ensure a positive return-on-investment for students who borrow;
4. Construct a student financial aid system that minimizes complexity of the student financial aid system in general and student loan system in particular;
5. Adopt policies that ease the financial burden of repayment for borrowers experiencing financial hardship;
6. Adopt policies that ensure that borrowers have necessary knowledge of loans before and after entering repayment;

7. Collect data to monitor experiences and outcomes of student loan recipients and engage in a regular program of research to understand the most effective policies and practices for improving student loan borrowers' outcomes and experiences.

Income-driven repayment plans appear to be an effective mechanism for reducing the risk to students that is associated with borrowing and easing the burden of repayment, especially for individuals with lower incomes. Lessons from the U.S. suggest that effective implementation of income-driven repayment requires government/taxpayer willingness to pay the related costs, a mechanism for easily and reliably determining borrowers' incomes, and clear communication about the availability and benefits of this repayment plan.

1. Introduction

Japan seeks to improve the efficiency and effectiveness of its student financial aid system in order to recognize constrained fiscal resources but while also maintaining student access to higher education. Japan differs from the United States in terms of many economic, political, demographic, historical, and other contextual characteristics. Yet, policymakers in the United States are facing a similar set of questions. The U.S. is also challenged to more strategically use available fiscal resources to increase the nation's overall level of higher education attainment and close gaps in higher education attainment across demographic groups (Perna & Finney, 2014).

As the responsibility for paying college costs has shifted from governments to students and their families, student loans have become an increasingly common type of financial assistance in nations across the globe. From the student perspective, loans are less attractive than grants, as, unlike grant aid, students must repay the amount of the loan, plus interest. Recognizing the potential negative consequences of loans for students, policymakers in Japan are particularly interested in understanding: 1) whether borrowers' loan debt and loan aversion are problems and, if so, how these problems might be addressed; 2) whether income-driven repayment is an effective strategy; and 3) how to improve financial literacy, particularly knowledge of loan programs, among high school and college students.

This paper offers insights for Japanese policymakers, drawing from what is known about student financial assistance in the United States. Examining student loans in the United States may be useful, given the magnitude of borrowing in this country. More than 9.2 million students received a federal subsidized or unsubsidized loan in 2013-14, up from about 6.5 million in 2003-04, although down from 10.3 million in 2011-12 (College Board, 2014). Over the past two decades, the total amount of student loan dollars increased steadily (in constant 2013 dollars) from an estimated \$31.3 billion in 1993-94 to a high of

\$122.1 billion in 2010-11, and then declined to \$106.0 billion in 2013-14 (College Board, 2014). Most (91%) loan dollars in 2013-14 were from programs sponsored by the federal government, while only 9% of loan dollars were from non-federal sources. The federal government awards Federal Subsidized Loans (24% of all loans in 2013-14), Federal Unsubsidized Loans (49%), Parent PLUS Loans (9%), Grad PLUS Loans (7%), and Perkins and other federal loans (2%) (College Board, 2014).⁹

The paper is organized to address the following four questions:

- Why do students in the U.S. use loans to pay college costs?
- What are the primary concerns about the use of student loans in the U.S.?
- What are government policies for addressing these concerns?
- What are relevant insights for future Japanese policymaking?

2. Why do students in the United States use loans to pay college costs?

Students in the U.S. use loans for at least three reasons:

1. Loans are a longstanding policy mechanism designed to enable students to pay the costs of attendance.
2. Loans are required to pay the growing share of college costs borne by students.
3. Loans are required to pay the growing costs of higher education.

1. Loans are a longstanding policy mechanism designed to enable students to pay college costs.

Student loans have long been used in the U.S. as a mechanism for encouraging more students to enroll in college. Federal student loans help to ensure that students have the financial resources required to pay college costs and thus help to shift the demand for higher education to the socially-optimal level (Paulsen, 2001; Avery & Turner, 2012). Federal loans provide a mechanism for students – most of whom do not have the credit history or credentials to receive loans on their own – to borrow funds at a relatively low

⁹ Efforts to identify the prevalence and magnitude of borrowing to pay college costs are limited by the absence of complete information about the use of loans from sources other than the federal government. In its annual *Trends in Student Financial Aid* reports, the College Board estimates the amount borrowed through loan programs sponsored by state governments and higher education institutions, as well as private loans from banks, credit unions, and other sources. Although potentially underestimating the total amount of borrowing through non-federal borrowing, the data published by the College Board clearly demonstrate that loans have become a common mechanism that students use to pay college costs.

interest rate.

What is now known as the federal Perkins loan was first authorized as part of the National Defense Education Act (NDEA) of 1958. What is now known as the Federal Stafford loan was first authorized by the Higher Education Act of 1965. Over time, the federal government has adopted additional loan programs and modified various aspects of federal loan programs, including eligibility criteria and borrowing limits. For instance, the 1992 amendments to the Higher Education Act expanded the availability of federal guaranteed student loans by increasing borrowing limits and making available unsubsidized federal loans to any student and the Parent PLUS Loan for any parent of a college student regardless of financial need (Chen & Wiederspan, 2014; Dynarski & Scott-Clayton, 2006). Changes in the authorized maximum loan amounts are an important determinant of the amount of federal loan debt that students in the U.S. accumulate, as those who borrow tend to borrow the maximum amount (Avery & Turner, 2012).

In the U.S. federal loans were originally viewed as a mechanism to improve college affordability for students from middle-income families. Need-based grant programs were assumed to ensure college affordability for students from low-income families (Gladieux, 1995). Many of the changes in the loan programs over time have also been adopted with a view toward assisting middle-income families (Zumeta et al., 2012). Despite this historical focus on students from middle-income families, today students in the U.S. with all levels of family income use loans to pay college costs.

Although providing a source of capital, loans come with costs to borrowers. In the 2014 report, *Borrowing Against the Future: The Hidden Costs of Financing U.S. Higher Education*, the Center for Culture, Opportunity, and Politics at the UC Berkeley Institute for Research on Labor and Employment estimates that interest payments on student loans (federal and nonfederal) amounted to \$34 billion in 2012, a 127% increase in constant dollars from the total amount in 2002.

Federal loans are now a common component of the financial aid packages that U.S. colleges and universities award to students. The four current federal loan programs are the Stafford subsidized loan, the Stafford unsubsidized loan, PLUS loans, and Perkins loans. To be eligible for federal financial aid, students (and, if students are financially dependent, their parents) must complete the Free Application for Federal Student Aid (FAFSA). (Completion of the FAFSA is also often required to determine eligibility for financial aid from states and higher education institutions.) Information from the FAFSA is used to calculate a student's "expected family contribution." Expected family contribution (EFC) is determined using a federally-legislated formula and takes into account a family's income, assets, family size, and number of family members attending

college. Colleges and universities then subtract the EFC from the costs of attendance to determine a student's eligibility for financial aid.¹⁰ Costs of attendance include the costs of tuition, fees, books, supplies, transportation, room and board, and other educational personal expenses and are adjusted to reflect a student's enrollment status (e.g., half-time, full-time).

Colleges and universities may attempt to meet at least some portion of students' financial need by awarding students a financial aid "package" that includes federal loans, as well as grants and/or work-study. In 2013-14, Federal Loans accounted for 34% of aid awarded to all undergraduates (\$62.9 billion) and 61% of aid awarded to all graduate students (\$33 billion) (College Board, 2014). In these calculations, financial aid includes federal loans, as well as: grants from the federal government, state governments, colleges and universities, private organizations and employers; "aid" that is allocated through the federal tax system (i.e., federal education tax credits and deductions); and "aid" that must be earned through work (i.e., federal work-study). Not considered in these statistics is the additional debt that students are incurring through private loans and other sources (e.g., credit card debt, home equity loan, loan from family members).

Students in the U.S. may also use loans to cover financial need that is not met by their financial aid packages. Relatively few U.S. higher education institutions have sufficient resources to meet 100% of the financial need that is not covered by federal or state government-sponsored financial aid for all students. The amount of "unmet need," defined as the amount of financial need that remains after subtracting loans, grants, and other discounts, has been increasing over time, and is highest for students from the lowest-income families, even though students from lower income families tend to attend institutions with lower costs of attendance (Cahalan & Perna, 2015). In 2012, average unmet need ranged from \$8,221 for students in the lowest family income quartile, to \$6,514 for students in the 2nd lowest family income quartile, to \$1,047 for students in the 3rd family income quartile; students from the highest income quartile had no unmet financial need (Cahalan & Perna, 2015). Borrowing (through private loans, credit cards, and other sources) is one of the few options that students in the U.S. have to pay college costs that are not covered by financial aid.

2. Loans are used to pay the growing share of college costs borne by students

¹⁰ Some institutions (e.g., University of Pennsylvania and other highly-selective colleges and universities) use additional criteria for determining need. For a listing of institutions that use "Profile" to capture more data than is collected on the FAFSA, see:

<https://profileonline.collegeboard.org/prf/PXRemotePartInstitutionServlet/PXRemotePartInstitutionServlet.srv>

Another reason that students in the U.S. are using loans is that, especially in recent years, the share of college costs that is borne by students and their families has increased while the share of costs paid by state and local funds has declined. State and local sources accounted for 57% of higher education institutions' revenue in 1977, but just 39% in 2012. Conversely, students and parents contributed about 33% of the revenue needed to support the higher education system in 1977, but 49% in 2012 (Cahalan & Perna, 2015).

The shifting responsibility for paying college costs from state and local government to students reflects an assumption that, as the primary beneficiary of higher education, students should pay the costs (Perna & Finney, 2014; Zumeta et al., 2012). Although the individual benefits of higher education are considerable, society also benefits when higher education attainment increases. With higher levels of educational attainment come not only higher earnings for individuals, but also public benefits like less reliance on social welfare programs, lower crime rates, greater civic engagement, and more (Baum, Ma, & Payea, 2013).

3. Loans are required to pay the growing costs of higher education

Students in the U.S. are also using loans to pay college costs because the costs of attendance have been increasing at a faster rate than inflation and family incomes. Growth in tuition and fees is one force that contributes to greater cost-sharing (Johnstone, 2010). The rate of growth in college costs has also exceeded the rate of growth in the Federal Pell Grant – the largest federally-sponsored grant program that is specifically targeted toward students with the demonstrated financial need. The purchasing power of the Pell Grant has diminished considerably over time, covering 67% of average college costs in 1975 but only 27% of costs in 2012 (Cahalan & Perna, 2015).

3. What are the primary concerns about the use of student loans in the U.S.?

Federal student loans have certainly provided a mechanism for many students and their parents to secure the financial resources required to pay college costs. As such, it is likely that the availability of federal student loans has helped shift the demand for higher education toward the socially-optimal level. Federal student loans have also likely eased the financial pressures that students, including students from middle-income families, experience as they endeavor to pay college costs.

Although some (e.g., Avery & Turner, 2012; Dynarski & Scott-Clayton, 2006) stress these and other benefits of loans, there are also reasons to be concerned about the use of loans in the U.S. to pay college costs. This section discusses the following four related concerns:

- 1) Implications of student loan debt for other life choices;
- 2) Prevalence of borrowing among students attending for-profit institutions;

- 3) Riskiness of loans, especially for students from low-income families and first-generation college students; and
- 4) Complexity of providing information about loans and repayment options.

1. Implications of student loan debt for other life choices

In the U.S. both the share of individuals with student loan debt and cumulative debt levels have been increasing. About 42% of all 25-year olds in the U.S. had student loan debt in 2012, up from about 26% in 2004 (Lee, 2013). In constant 2013 dollars, average debt per borrower rose over the past decade from \$22,900 in 2002-03 to \$27,300 in 2012-13, while average debt per graduate grew from \$12,800 to \$16,500 (College Board, 2014). Over the past decade, inflation-adjusted total outstanding student debt increased by 152%, the number of borrowers with outstanding student loan debt increased by 86%, and inflation-adjusted average outstanding student loan debt per borrower increased by 35% (College Board, 2014).

Some recent research in the U.S. suggests that with greater student loan debt comes greater psychological stress and financial worries (Walsemann, Gee, & Gentile, 2015).

Student loan debt may also influence students' willingness to engage in other life activities, including enrolling in graduate education, getting married, having a family, and buying a house (Gale, Harris, Renaud, & Rodihan, 2014; Heller, 2008). Total student loan debt rose steadily over the past decade – even during the Great Recession. Moreover, since 2008, other types of non-mortgage debt, such as auto loans and credit card debt, have declined (Lee, 2013). Declines in non-student debt have been particularly large among borrowers with the highest student loan debt (Lee, 2013).

2. Prevalence of borrowing among students attending for-profit institutions

Another concern about student loans is the high rate and amount borrowed among students attending for-profit institutions. Both the rate of borrowing and the amount borrowed are higher, on average, for students attending for-profit institutions than for students attending other types of institutions (College Board, 2014). For instance, nearly all (88%) students graduating with bachelor's degrees from for-profit institutions in 2011-12 used loans, compared with 75% of students at private not-for-profit institutions and 66% of students at public institutions (Cahalan & Perna, 2015). Nearly half (48%) of individuals who received bachelor's degrees from for-profit institutions in 2011-12 had more than \$40,000 in cumulative debt, compared with only 20% of those who received their degrees from private non-profit four-year institutions and 12% of those who received their degrees from public four-year institutions (College Board, 2014). Only 14% of individuals who received certificates from for-profit institutions in 2011-12 had no cumulative debt, compared with

65% of those who received certificates from public two-year institutions (College Board, 2014).

The higher rates and amounts of borrowing among students who attend for-profit institutions are concerning because rates of completion are lower, on average, at these institutions than at other types of higher education institutions. Only 42% of students who entered a for-profit four-year institution for the first-time, full-time in 2005 completed a bachelor's degree within six years, compared with 57% of students who began at a public four-year institution and 65% who began at a private not-for-profit four-year institution (National Center for Education Statistics, 2013).

High rates of borrowing for students who attend for-profit institutions are also of concern because of the uncertain economic value associated with the credentials that are earned at some of these institutions. Research shows that unemployment rates are higher and average earnings are lower for students who attend for-profit institutions than for their peers who attend other types of institutions (Deming, Goldin, & Katz, 2011).

Given the patterns in completion and employment, it is not a surprise that students who attend for-profit institutions average higher default rates than students who attend other types of institutions. In FY 2011, borrowers who attended for-profit institutions represented 44% of those in default and 32% of those in repayment, but only 10% of full-time equivalent enrollments (College Board, 2014).

3. Riskiness of loans

Because the amount borrowed must be repaid (with interest in the U.S.), loans are inherently risky. Most students borrow relatively small amounts. In 2013, 40% of loan balances were less than \$10,000 and an additional 29% were between \$10,000 and \$25,000; just 13% exceeded \$50,000 (College Board, 2014).

Research shows, however, that the amount borrowed is a far less important predictor of student loan default than the type of institution attended, whether the student finishes the program of study, and whether the student obtains a job after completing the degree program (Hillman, 2014). A student is much more likely to attain a job that pays the earnings required to repay a loan debt if the student successfully completes the curricular program (Gladieux & Perna, 2005). Completion rates are low at many higher education institutions in the U.S. On average, only 39% of students who entered a four-year institution for the first-time, full-time in 2005 completed a bachelor's degree within four years; only 59% completed within six years (National Center for Education Statistics, 2013).

Current and prospective students have varying tolerance for the risks of loans, leading to differences in the willingness to use loans to pay college costs. Consistent with the economic theory of human capital, scholars (e.g., Perna, 2006) assume that, fundamentally,

students make decisions about whether to enroll and persist in college based on a comparison of the expected net benefits with the expected costs. As an obligation that must be repaid, a student may not perceive that student loans reduce the costs of attending college. Moreover, student loans come with costs, including the interest on the amount borrowed and loan origination fees. Some research (e.g., Perna, 2008) suggests that individuals from low-income families and who are the first in their families to attend college are particularly reluctant to use loans to pay college costs, while other studies (e.g., IHEP, 2008) find differences in the willingness to take on debt among students from different racial/ethnic groups. Some who are unwilling to borrow may forgo higher education, enroll at a less-expensive institution, or enroll part-time rather than full-time – choices that all are associated with lower degree completion rates. Others may attempt to finance college costs by forgoing loans and instead engaging in high amounts of paid employment (Gladieux & Perna, 2005). Yet, working a high number of hours limits the amount of time students can devote to their coursework, and also often leads to longer time-to-degree and lower rates of degree completion (Perna, 2010).

Some of the varying willingness to borrow would seem to be appropriate, particularly among students from low-income families. Default rates tend to be higher for students from low-income families than for students from higher-income families, and higher for students from racial/ethnic minority groups than for White students (Gross et al., 2009; Hillman, 2014). Default is problematic, as borrowers who default on their loans may experience “a damaged credit rating, tax refund offset, or garnished wages” (The Domestic Policy Council, The Council of Economic Advisers, 2014, p. 11). A damaged credit rating may impact “one’s ability to purchase or rent a home, open a bank account, or finance a vehicle” or even the hiring process (if a credit check is required for a particular position). Even if students do not default on their loans, high debt burdens may cause other financial hardships and reduce their ability to pay off other debt (The Domestic Policy Council, The Council of Economic Advisers, 2014).

4. Complexity of providing information about loans and repayment options

The complexity of the student financial aid system in the U.S. complicates efforts to ensure that all students have accurate and complete knowledge and information about the requirements and obligations of their loans. As the U.S. Department of Education (2010) notes, accepting a loan “is as simple as signing a promissory note” (p. 16). But, making sure that students understand the terms of the promissory note is more complicated.

Many forces contribute to the complexity of providing information about loans, including changes in the provisions and structure of loan programs over time, the multiple providers of loans, and the lack of standardization of financial aid award letters. These and other forces contribute to confusion among students about the terms and obligations of

the financial aid that they are awarded, as well as other misunderstandings (e.g., the distinction between grant and loan aid) (Advisory Committee on Student Financial Assistance, 2011; Perna, 2008).

Students are borrowing funds from multiple forces to pay college costs. These sources include the federal government, as well as non-federal sources including private lenders, colleges and universities, friends and relatives, and other sources. Even when loans are only from the federal government, eligibility criteria and terms (e.g., interest rate, annual loan limit, maximum loan limit, lender, grace period) depend on whether a loan is a Federal Perkins Loan, Direct Unsubsidized Stafford Loan, Direct Subsidized Stafford Loan, Direct PLUS Loan, or Direct Consolidation Loan. In 2013-14, 24% of undergraduates had both subsidized and unsubsidized loans, 6% had only subsidized loans, and 4% had only unsubsidized loans (College Board, 2014).

Financial aid administrators at higher education institutions in the U.S. perceive that “misinformation and miscommunication between [loan] servicers and borrowers” contributes to “confusion, misunderstanding, and ultimately, missed payments and default” (NASFAA, 2015, p. 6). Understanding payment and repayment options is complicated when borrowers have “multiple loans, with different terms, conditions, and servicers” (NASFAA, 2015, p. 6). Because the U.S. Department of Education has not developed a standardized set of procedures for loan servicers, “not all servicers are handling servicing procedures in the same manner” (p. 9), leading to confusion among borrowers and challenges for financial aid administrators who wish to counsel borrowers. In its report, NASFAA also notes that, unlike other types of consumer debt, federal student loans in the U.S. do not have such “typical consumer credit protections” as “standardized processes for statements and payment handling, service transfers, error resolutions, delinquency servicing, and military service” (p. 8).

Efforts by financial aid administrators to ensure that students have accurate and complete information about their loans are complicated by the complexity of student enrollment patterns. In the U.S., the onus is on students to notify their loan servicer when they graduate, withdraw, change enrollment status (e.g., to less than half-time), transfer to another institution, or enroll in graduate school, or when they change their name, address, or Social Security number (U.S. Department of Education, 2010).

4. U.S. Government policies for addressing concerns about student loans

The federal government has adopted – to varying degrees – a number of policies for addressing concerns about student loans. This section provides an overview of policies with the following goals:

- Reduce the need for students to borrow;

- Reduce the use of private loans;
- Encourage positive return on a higher education investment;
- Forgive loans for borrowers who meet particular requirements;
- Provide mechanisms for borrowers to temporarily reduce payments;
- Reduce the financial burden of repayment; and
- Improve students' knowledge of loans.

1. Reduce the need for students to borrow

One policy strategy for addressing concerns about loans is to reduce the need for students to borrow. Policymakers can reduce the need for students to borrow through policies that encourage higher education institutions to control or limit increases in the costs of attendance, increase the share of costs that are covered by state and local governments (e.g., through state and local government appropriations to higher education institutions), and increase the availability of need-based grants from the federal government (e.g., Federal Pell Grant), state governments, and colleges and universities.

One institution-level policy to emerge over the past decade is the Loan Replacement Grant (LRG) initiative. A very small number (approximately 50) highly selective four-year colleges and universities in the U.S. have adopted LRG programs that either entirely replace loans with grant aid in students' financial aid packages (i.e., "no-loan") or greatly reduce loan burden by capping the amount of loans offered to students (Lips, 2011; Perna et al., 2011). As suggested by the trends discussed earlier in this paper, however, more effort is required in the U.S. to productively reduce the need for students to borrow.

2. Reduce use of Private Loans

Federal student loans offer distinct financial benefits over private student loans that include a fixed and typically lower interest rate; an interest subsidy (i.e., the government pays the loan interest while high-need students are enrolled in college); and safeguards for students who face financial hardships (e.g., deferment, forbearance, income-driven repayment plans) (Federal Student Aid, 2015b). Despite the benefits of federal loans, students in the U.S. may elect to take private loans for several reasons. They may attend institutions with a high cost of attendance and have unmet financial need. Some students may use private loans without full understanding of the distinctions between federal and private loans, as some users of private loans have not borrowed the maximum amount allowed under the (lower-cost) Direct Loan program (Consumer Financial Protection Bureau, 2012; Wegmann, Cunningham, & Merisotis, 2003).

In the U.S. the use of private loans grew steadily through the mid-1990s to reach a high of 26% of all loan dollars in 2006-07 (College Board, 2014). During the rapid growth period from 2005-2007, private lenders increased marketing directly to students and

relaxed borrowing qualifications (e.g., giving loans to individuals with lower credit scores and without demonstrated financial need) (Consumer Financial Protection Bureau, 2012). Since 2008 private lenders have changed their underwriting policies, however, and now require more loans to be co-signed and have tightened credit standards. The College Board (2014) reports that the share of loan dollars from private sources declined from 12% in 2008-09 to 9% in 2012-2013.

The Higher Education Act of 1965 included the authorization of the Guaranteed Student Loan (GSL) program. Whereas the National Defense Student Loan Program used federal capital to provide student loans, the GSL program (later renamed Federal Family Educational Loan program) combined private capital with federal subsidies to banks. Essentially, the federal government provided a subsidy to ensure banks would realize a specified interest rate, guaranteed nearly all loan principal and interest in case of a borrower's default, and paid service fees to loan guaranty agencies (Field, 2010). Over time, economists and policymakers cited the FFEL program as inefficient and prone to abuse among private lenders. With the federal government's increased role in providing capital to banks for student lending during the credit crunch of the Great Recession, the FFEL program essentially became a "subsidy-laden version of Direct Lending" (Field, 2010, para. 15). The Student Aid and Fiscal Responsibility Act in 2010 eliminated the FFEL program and the associated subsidies to lenders. Since July 2010, all new federal student loans have been made under the Direct Loan program (New America Foundation, 2012).

3. Encourage positive return on investment

Another public policy strategy for addressing concerns about loans is to increase the likelihood that students will realize a positive return on their investment in higher education (and thus have the employment and earnings required to repay the amount borrowed). One approach is to adopt policies that promote meaningful improvements in college completion rates. Some state policymakers have adopted "outcomes" or "performance" based assessment or funding policies with the goal of financially rewarding institutions that meet college completion targets. As of December 2014, 26 U.S. states were allocating funding to implement performance-based funding policies, and 10 more were developing such policies (Snyder, 2015). The implemented policies vary on many dimensions, including the percentage of total state funding for higher education institutions that is allocated based on performance and the particular measures of performance. Although politically popular, however, research to date suggests that these policies have had a minimal impact on increasing college retention and completion rates (e.g., Dougherty et al., 2014; Rutherford & Rabovsky, 2014).

A federal policy that may be intended to ensure that borrowers realize a positive return

on their investment is the Gainful Employment regulation issued in October 2014 by the U.S. Department of Education. The regulation makes eligibility for federal student aid conditional on the debt-to-earnings ratio of students who graduate from vocationally-oriented postsecondary education programs that are expected to lead to the gainful employment of graduates (U.S. Department of Education, 2014). Student loan default rate was one of the initially proposed metrics but was not included in the final regulations (Fain, 2014). Although not limited to for-profit institutions, the U.S. Department of Education (2014) estimates that, if implemented, 99% of the 1,400 programs that will not meet the requirements of the new regulation are located at for-profit institutions.

The Gainful Employment regulation is scheduled to become effective July 2015, but implementation remains uncertain. In November 2014 the Association of Private Sector Colleges and Universities (APSCU), an organization that represents for-profit colleges, filed a lawsuit seeking to overturn the measure. The APSCU lawsuit mirrors the response of a lawsuit filed against a 2011 version of the gainful employment regulation. After three years of litigation, a federal judge ruled against the U.S. Department of Education's earlier version of gainful employment in 2013.

4. Forgive loans for borrowers who meet particular requirements

The National Defense Student Loan System, established as part of the National Defense Education Act of 1958, was the first federal financial aid policy to include a loan forgiveness clause (Fuller, 2014). Under this clause, borrowers could have a portion of their loan forgiven for each year of teaching in a public elementary or secondary school. Today, under the Federal Perkins Loan Program, borrowers may have a percentage of their debt cancelled for each year completed in specified areas of public service (e.g., Peace Corps, U.S. armed forces, Head Start, nursing) (Federal Student Aid, 2015c).

The federal government also offers other loan forgiveness programs. Through the Teacher Loan Forgiveness Program, borrowers may have up to \$17,500 of their Direct Loan balances forgiven if they teach in a low-income elementary or secondary school for five consecutive years. Established as part of the College Cost Reduction and Access Act of 2007, the Public Service Loan Forgiveness Program is the federal government's most recent and least restrictive loan forgiveness program. Through this program, borrowers may have outstanding Direct Loan debt forgiven after they have made 120 regular payments while working full-time for a qualifying public service organization (Federal Student Aid, 2015c).

In addition to loan forgiveness, the federal government will also cancel and discharge loans under certain conditions. For borrowers who become permanently disabled or die, all federal loans are discharged. The federal government may also discharge a student's

loans if the higher education institution attended closes before the student can complete the program of study or closes within 120 days of a student's withdrawal from an institution. The federal government does not automatically discharge outstanding federal loan debt for student bankruptcy (Federal Student Aid, 2015c).

Few studies have examined the effectiveness of forgiveness programs. Nonetheless, these programs are politically and publicly supported as a mechanism for addressing workforce needs and promoting college affordability (Harnisch, 2009).

5. Provide mechanisms for borrowers to temporarily postpone or reduce payments

The federal government allows borrowers to temporarily stop or reduce loan payments through two mechanisms: deferment and forbearance. Through a deferment, borrowers postpone repayment of principal and interest. During the period of deferment, the federal government may pay the interest for Federal Perkins and Direct Subsidized Loans. For other loans, interest will continue to accrue. Deferments are available for borrowers who are enrolled in a postsecondary educational program at least half-time or an approved graduate fellowship program, unemployed, experiencing economic hardship or serving in the Peace Corps, serving in the military during a war, military operation, or national emergency (Federal Student Aid, 2015a). Borrowers who do not qualify for deferment may apply for a forbearance. A forbearance will allow a borrower to postpone or reduce payments for up to 12 months (although interest will continue to accrue). A lender may grant a discretionary forbearance to borrowers experiencing financial hardship or illness and is required to grant forbearance to eligible borrowers in a medical or dental internship or residency program, borrowers for whom monthly student loan payments represent more than 20% of their monthly gross income, and borrowers who are serving in various national service, teaching service, or military service capacities (Federal Student Aid, 2015a).

NASFAA (2015) recommends that the U.S. Department of Education standardize policies and procedures related to approving requests for deferment and forbearance, as well as policies and procedures pertaining to the sharing information between servicers when the designated loan servicer changes, requesting from institutions updated borrower contact information, reporting to credit agencies, processing of public service loan forgiveness income-driven repayment, applying pre-payments, training servicers, and measuring the quality of customer service.

6. Reduce the financial burden of loan repayment

The standard repayment plan for federal student loans borrowers in the U.S. is 120 equal monthly payments (that is, monthly payments for 10 years). The federal government offers three repayment options designed to lower monthly payments. One option allows borrowers to keep the same 10-year repayment period but with graduated payments; initial

monthly payments are low but then gradually increase over time until the loan is repaid. A second option allows borrowers to extend the repayment period to up to 25 years, with fixed or graduated monthly payments (Federal Student Aid, 2015d). A third option is income-driven repayment.

Income-driven repayment plans were first authorized as part of the 2008 amendments to the Higher Education Act (Akers & Chingos, 2014). There are now three types of income-driven repayment plans: Income-Based Repayment (IBR), Income-Contingent Repayment (ICR), and Pay As You Earn Repayment (PAYE). Under these plans “borrowers make monthly payments based on their earnings rather than a traditional schedule of flat payments” (Akers & Chingos, 2014, p. 2). IBR and PAYE plans limit maximum monthly payments to 15% and 10% of discretionary income, respectively, while ICR monthly payments are the lesser of 20% of discretionary income or an income-adjusted fixed payment calculated over a 12-year repayment plan (Federal Student Aid, 2015d). For all income-driven repayment plans, unpaid loan debt is forgiven after 20 to 25 years. All Direct Loan borrowers whose high loan amounts and/or low earnings prevent them from repaying their loans in the traditional 10-year timeframe (i.e., Standard Repayment Plan, Graduated Repayment Plan) are eligible to enter IBR and PAYE plans. The same eligibility guidelines hold for participation in the ICR plan, except that parents who received PLUS loans on behalf of their student are not eligible (Federal Student Aid, 2015d).

Income-driven repayment plans may have some unintended negative consequences including encouraging borrowers to pursue lower-paying jobs or higher education institutions to increase tuition (Gillen, 2013). But, income-driven repayment also has benefits, including easing the burden of repayment and eliminating “the possibility of default” (Gillen, 2013, para. 5). Both IBR and PAYE plans may be especially important to low-income borrowers. In a simulation of repayment patterns for those who obtain a bachelor’s degree, Akers and Chingos (2014) projected that three-quarters of participants in these plans would be “borrowers with incomes in the lowest quartile” (Akers & Chingos, 2014, p. 2).

At least three forces have limited the effectiveness of income-driven repayment plans in the U.S. One pertains to political opposition to the financial costs of these plans. The government’s cost of these plans is influenced by the repayment requirements, including the number of payments before a loan is forgiven and the percentage of income at which monthly payments are capped (Gillen, 2013). The plans also have administrative costs. Akers and Chingos (2014) estimate that the extended repayment (with lower monthly payments) of IBR and PAYE plans would account for a third of the cost. The remaining costs come from the loan interest benefit and loan forgiveness.

In the U.S. the continued role of income-driven repayment plans will depend on the federal government's willingness to pay the financial costs. In June 2014 President Obama proposed expanding the PAYE program to serve an additional five million student loan borrowers by December 2015 (The Domestic Policy Council, Council of Economic Advisers, 2014) and in early 2015 proposed an increase of \$21 billion for all income-driven repayment plans (Stratford, 2015). Nonetheless, in March 2015 Republican members of the House of Representatives challenge expansion of income-driven repayment because of the financial costs to the government/taxpayers (Field, 2015a, para. 2).

A second force influencing the effectiveness of income-driven repayment in the U.S. pertains to the processes for determining borrowers' incomes. The Internal Revenue Service (IRS) and the Department of Education partnered in 2012 to create "an online application that lets borrowers get their required income information directly from the IRS" (The White House, 2015). Nonetheless, borrowers who select income-driven repayment must still annually certify their income. Those who do not provide the required certification are shifted from income-driven repayment to the standard repayment plan (Field, 2015b). Between 2013 and 2014, 57% of the 700,000 borrowers in income-driven repayment plans did not provide the necessary certification on time (Field, 2015b). Although some borrowers subsequently re-enrolled in income-driven repayment plans, others became delinquent (Field, 2015b). President Obama has called for continued collaboration between the Departments of Treasury and Education "to simplify the process to verify income and keep borrowers enrolled in income-driven repayment plans" (The White House, 2015, para. 6).

The effectiveness of income-driven repayment in the U.S. is also limited by the relatively low rates of participation. Although the U.S. Department of Education has engaged in efforts to communicate the availability of income-driven repayment especially to delinquent borrowers, the share of borrowers who select this repayment option continues to be lower than projected (Field, 2015b; "Modest uptick for income-based repayment," 2014). In 2013-14, nearly two-thirds (63%) of Federal Direct Loan recipients with outstanding balances were using the standard repayment plan (with level payments for ten years or less). About 9% were using level payments over more than 10 years, 12% were using graduated repayment, and 14% were using income-driven (College Board, 2014). The 14% of borrowers who were enrolled in income-related repayment driven plans held 28% of the Federal Direct Loan program's outstanding debt (College Board, 2014).

7. Improve students' knowledge of loans

Young adults in the U.S. are required to exercise judgment with complex financial decisions pertaining to student loans, credit cards, and other types of debt. Research

suggests that financial illiteracy is a problem among youth in the U.S., particularly for racial/ethnic minorities, women, and youth from households with low educational attainment (Lusardi, Mitchell, & Curto, 2009). Perhaps because of insufficient financial literacy, some students are not borrowing optimally (Avery & Turner, 2012). Sub-optimal use of loans includes the use of (expensive) credit card debt rather than student loans to pay college costs and the tendency to work a high number of hours while enrolled rather than borrow (Avery & Turner, 2012; Gladieux & Perna, 2005).

With the goal of improving knowledge and understanding of student loans, the U.S. Department of Education requires that all first-time borrowers complete entrance counseling before they receive their first loan disbursement and complete exit counseling before the end of enrollment at their higher education institution. (Loan counseling is not required for recipients of Parent PLUS loans.) These 30-minute online counseling “sessions” include information intended to help students: “understand your loans, manage your spending, plan to repay, avoid default, and make finances a priority” (U.S. Department of Education, n.d., para. 3). The U.S. Department of Education also offers optional online Financial Aid Counseling, designed to provide “tools and information” pertaining to financial aid and financial management.

Some (e.g., NASFAA, 2015) argue that the U.S. Department of Education should also require borrowers to complete the Financial Awareness Counseling tool. According to NASFAA (p. 9), this tool provides borrowers with a more complete understanding of the benefits of various repayment strategies as well as “budget management exercises, including an in-school budgeting tool; and tips and options to avoid default by postponing repayment or reducing monthly payment amounts.”

Developed by the Obama Administration, the College Scorecard and the Financial Aid Shopping Sheet are additional tools intended to help families make more informed financial decisions (The Domestic Policy Council, The Council of Economic Advisers, 2014). Each institution’s College Scorecard now includes data for four indicators (average net price, six-year graduate rate, federal student loan default rate, and median federal loan borrowing) and has a placeholder for a fifth forthcoming indicator (employment outcomes). In December 2014 the Obama Administration released plans for a new “College Rating System” that is expected to provide additional indicators of higher education institutions’ performance prior to the beginning of the 2015-16 academic year.

Implemented in the 2013-2014 academic year and adopted by more than 2,000 postsecondary institutions, the Financial Aid Shopping Sheet is a standardized financial aid award template that is designed to facilitate cross-institution comparisons for prospective students and their families.

Some observers assert the effectiveness of outreach and communication efforts in increasing borrowers' knowledge of loans. In an effort to increase Direct Loan borrowers' awareness of their repayment options and reduce repayment burden, "outreach efforts by the Department of Education, and the Department of Treasury's work in partnership with private sector tax preparers, have contributed to greater numbers of student borrowers enrolling in income-driven plans" (The Domestic Policy Council, The Council of Economic Advisors, p. 12-13). Enrollment in income-driven repayment plans increased by more than 40% since the "awareness campaigns" began in summer 2013.

5. What are relevant insights for future Japanese policymaking?

Nations around the globe are responding to the need to achieve greater access to higher education in the context of fiscal resource constraints by shifting more of the responsibility for paying college costs on students and their families. By providing a mechanism for students and their families to pay the costs, student loans help to encourage the socially-optimal level of investment in higher education (Avery & Turner, 2012).

Despite these potential benefits, this review identifies a number of concerns about the use of student loans in the United States. While this review also describes various policies that have been adopted in the U.S. to address these concerns, very few studies have examined the effects of these policies on student outcomes. Based on his comprehensive review and synthesis of prior research, Heller (2008) concluded that the effects of student loans on college access are ambiguous. Dynarski and Scott-Clayton (2013) also observe the absence of rigorous studies on the effects of loans on college enrollment, performance, or completion. Little also is known about the effects of different efforts to improve students' knowledge of loans or ease the burden of loan repayment.

The transferability of the insights identified about the U.S. in this paper to Japan is limited by the many differences in the economic, political, historical, and demographic contexts of the U.S. and Japan, as well as the differences in the higher education systems of the two nations. Nonetheless, from this consideration of the concerns about loans and related government policies in the U.S., we offer the following suggestions to Japanese policymakers:

5. Consider how the costs of higher education should be shared among relevant stakeholders and adopt policies that achieve this cost-sharing;
6. Adopt policies that reduce the need for borrowing, especially for students most at risk for not completing their degree programs;
7. Adopt policies that ensure a positive return-on-investment for students who borrow;

8. Construct a student financial aid system that minimizes complexity of the student financial aid system in general and student loan system in particular;
9. Adopt policies that ease the financial burden of repayment for borrowers experiencing financial hardship;
10. Adopt policies that ensure that borrowers have necessary knowledge of loans before and after entering repayment;
11. Collect data to monitor experiences and outcomes of student loan recipients and engage in a regular program of research to understand the most effective policies and practices for improving student loan borrowers' outcomes and experiences.

Implicit in these suggestions is the need for policies that increase access and minimize risk, especially for students from groups that are historically underrepresented in higher education and students who are most at risk for not completing a higher education degree.

Income-driven repayment plans appear to be an effective mechanism for reducing the risk of borrowing to students and easing the burden of repayment, especially for individuals with lower incomes. Lessons from the U.S. suggest that effective implementation of income-driven repayment requires government/taxpayer willingness to pay the related programmatic costs and a reliable mechanism for automatically and seamlessly determining borrowers' incomes. Particularly if income-driven repayment is one of several repayment options, then Japanese policymakers should also consider the most effective approaches for communicating to borrowers about the availability and advantages of this repayment option.

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Chapter 4

Local Student Financial Aid in China: Backgrounds, Institution, and Information

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Chapter 4

Local Student Financial Aid in China: Backgrounds, Institution, and Information

Jianguo Wei

Student financial aid system have been gradually set up and improved since the end of the last century, when China began its move towards mass higher education. In this paper, firstly, I will present the basic facts of China's higher education, which are the backgrounds of student financial aid system; secondly, I will introduce the historical development of student financial aid system in China; then, I will focus on China's student loans schemes; lastly, I will discuss information regarding college costs and student financial aid.

1. Basic facts of China's higher education

1. The gross enrollment ratio of higher education in China

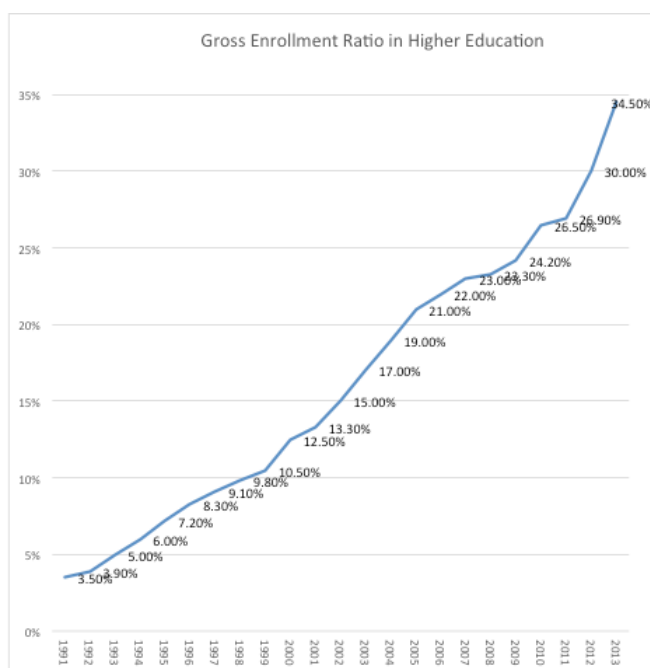


Figure 13 The Gross Enrollment Ratio of Higher Education in China

Over the past 15 years, China's higher education has achieved great success in enrollment. China's higher education began grand expansion in 1999. Before 1999, the gross enrollment ratio of higher education in China is below 10%. The ratio was only 3.5% in 1991. However, the ratio quickly reached 15.00% in 2002, which is the benchmark of the massification stage of higher education (Trow 1973). In 2013, the ratio was 34.5%. According to the *National Medium and Long Term Planning Outline for Education Reform and Development* issued by the State Council, the gross enrollment ratio of higher education will reach 40% in 2020.

2. Number of HEIs (not including adult education institutions) in China

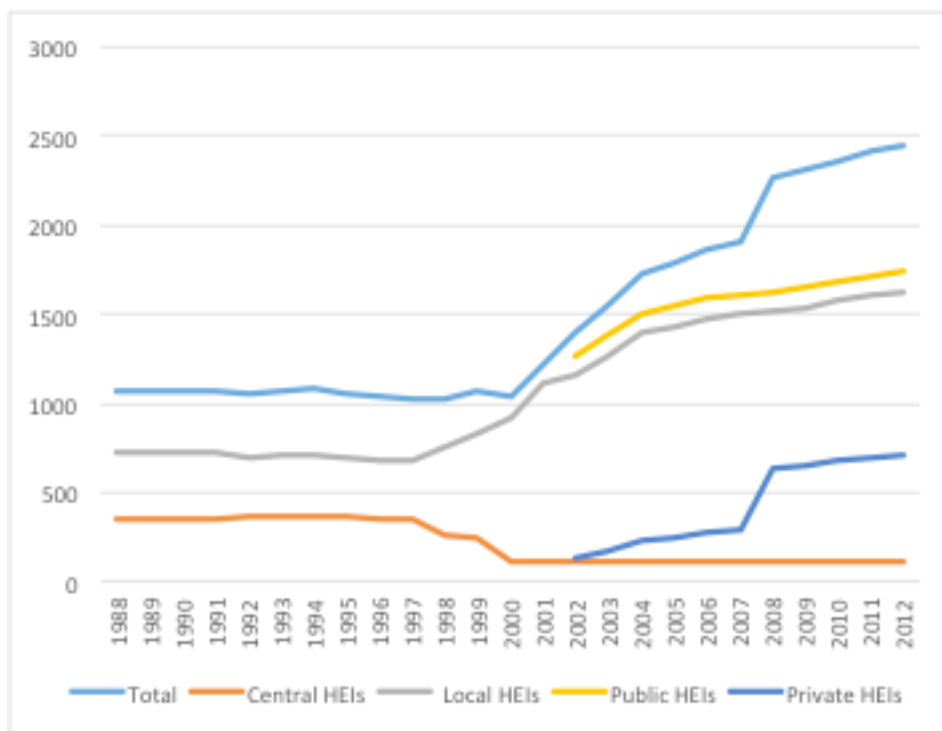


Figure 14 Number of HEIs in China

Regarding the number of HEIs, it kept relatively stable during the 1980s and 1990s, the number's increase was stimulated by the grand expansion which occurred in 1999. Nowadays, there are over 2400 universities and colleges in China. The majority of them are public institutions, which is about 70% of all institutions. Among the public sector, there are two kinds of institutions: central HEIs and local HEIs. Regarding the quantity, the local HEIs (66.5%) are far more than the central HEIs (4.6%). However, regarding the quality, generally speaking, the central HEIs are better than local ones.

In addition, I will talk a little bit about elite HEIs in China. In the 1990s, Chinese government implemented two important national projects aiming to build up world-class universities, which are named by project “985” and project “211”. The universities covered by these two projects will receive extra financial support from governments. There are 112 “211” universities, and 39 “985” universities. All of these elite HEIs are public institutions. Nowadays, the two projects have been undergoing reform.

3. Annual enrollment of HEIs in China

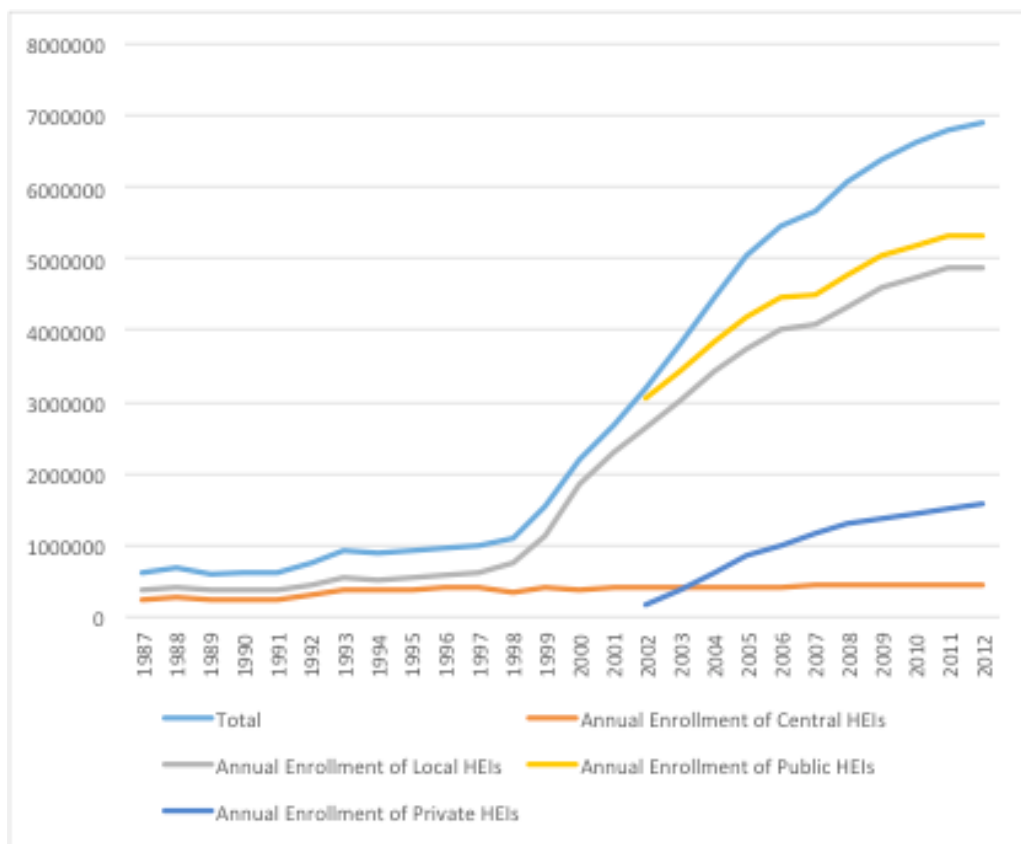
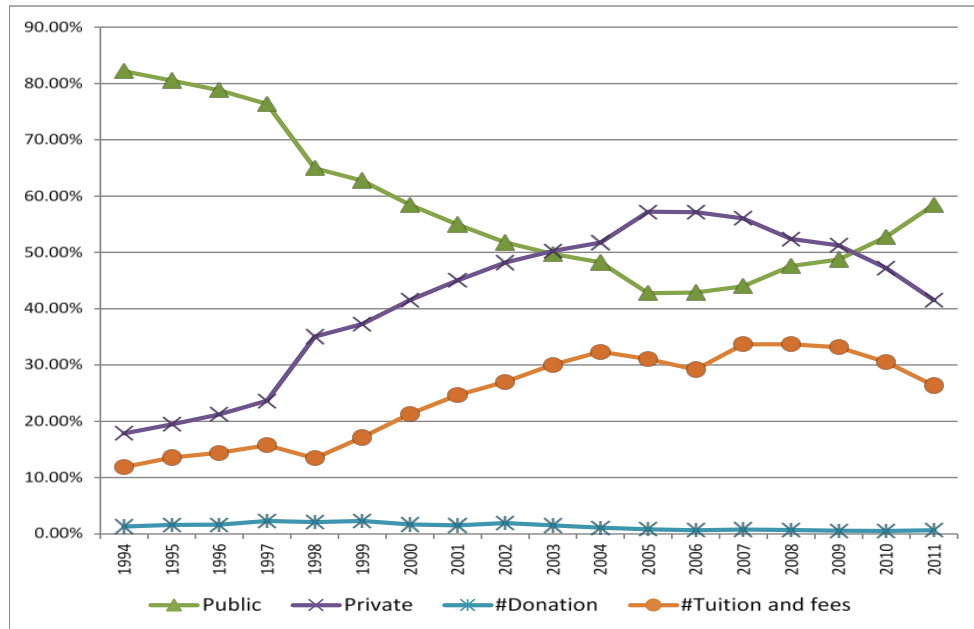


Figure 15 Annual Enrollment of HEIs in China

Just like the number of HEIs, annual enrollment of HEIs also kept relatively stable before 1999. Annual enrollment of HEIs in China has increased rapidly since 1999’s grand expansion. In 1998, there are only about 1 million new students enrolled in HEIs. However, in 2012, this number reached about 7 million. It is worth noting that the majority of the students were enrolled in local HEIs. For example, in 2012, about 70% of all students were enrolled in local HEIs, meanwhile, over 20% were enrolled in private HEIs, only about 7% were enrolled in central HEIs.

4. Composition of expenditure of China's HEIs



Source: China's Yearbook for Education Finance Statistics.

Figure 16 Composition of Expenditure of China's HEIs

Regarding the composition of expenditure of China's HEIs, public sector's share decreased from about 80% in 1994 to about 40% in 2005, then, the percentage began to gradually increase and surpass the private share in 2010. In 2011, the public share was about 60%, meanwhile, the tuition and fees covered about 26% of all expenditure. In addition, the donation share has been very low since 1994.

It is worth noting that higher education is considered as quasi-public goods in China, which can produce public benefits and private benefits. Therefore, nowadays, the cost-sharing theory (Johnstone 1986) are widely accepted in China.

2. Historical development of student financial aid system in China

1. Phase 1: Before the 1999's Grand Expansion

China gradually implemented cost-sharing policy at the end of last century. Originally, higher education was free in China. However, the dual-track tuition policy was implemented during the 1980s and 1990s.

All students have begun to pay tuition since 1997.

During that time, government gradually implemented some financial aid policies, such as institutional interest-free loan which differs from student loan program that will be mentioned in the latter part of this paper in 1987, subsidy for needy student in 1993,

work-study program in 1994, and tuition reduction or waiver in 1995.

2. Phase 2:1999 to 2003

The grand expansion stimulated the development of student financial aid system.

Central HEIs in eight cities adopted a pilot National Student Loan Program in 1999 through Industrial and Commercial Bank of China (ICBC). Central government subsidized the program by paying loan interest. In year 2000 the pilot extended to a nationwide program, and the other banks joined ICBC to provide National Student Loan.

To guarantee low-income students could matriculate into college smoothly once they were admitted, MOE and MOF jointly mandated HEIs to build up a so called “GREEN CHANNEL” program in 2000, which allowed admitted students from low-income families to enroll in college first without paying tuition. Once HEIs verified their household financial status, colleges and universities provided them with appropriate financial aid packages.

China initiated the National Fellowship Program, which supports low-income and academically excellent students, in 2002.

3. Phase 3: 2004 to 2006

The National Student Loan Program met great challenges in 2003. Most commercial banks were reluctant to distribute student loans because of the huge number of individual loan service to provide, small amount of loan payment per service, high maintenance cost and relative high risk of default. MOE, MOF, and other financial agencies mandated a new policy in 2004. The new policy made adjustment for the student loan program: introduction of risk compensation fund, extending repayment period.

In 2005, Chinese government reformed its National Fellowship Program. The new program had two parts: the National Fellowship program targeted at needy and capable student; the National Grant Program intended to support full-time students from extremely poor families.

4. Phase 4: 2007 to date

The State Council implemented a new policy (Opinions on Establishing and Improving the Policies for Subsidizing Students in Universities of Regular Undergraduate Education, Post-secondary Vocational Schools and Secondary Vocational Schools from Families with Financial Difficulties) for student financial aid in 2007.

The new policy made significant changes for original student financial aid system, which was the largest adjustment since 1999. The 2007’s policy is a milestone in the history which set the institutional foundation for China’s student financial aid.

The aforementioned new policy mainly regulates the following areas:

(a) Enhancing the National Fellowship Program.

Central government is the sole provider of the fund. The program will no longer focus on

needy students. It will be transformed into a merit-aid program with a single goal of rewarding the most capable students.

(b) Central and local government will co-sponsor the **National Incentive Fellowship**, which will reward academically acclaimed students from low-income households.

(c) Enhancing the **National Grant program**. Central and local government will co-sponsor the National Grant program, which provides financial aid for needy students.

(d) **Home-based student loan** supplied by China Development Bank will be piloted in Jiangsu, Hubei, Chongqing, Shaanxi, Gansu.

In addition, there have been many policy adjustments since 2007, especially for student loans, such as increasing the maximum amount, extending the repayment period, etc.

3. Student loan schemes: HEI-based v. Home-based

Student loan plays a very important role in China's student financial aid system, which contributes about 30% of total sum. Generally speaking, there are two kinds of student loans schemes in China: HEI-based student loan provided by commercial bank and China Development Bank, Home-based student loan provided by China Development Bank. In this part, a simple comparison of student loans schemes is made.

Regarding the borrower eligibility, the borrowers of HEI-based student loan are students. However, the borrowers of home-based student loan are students and their parents, Students and their parents are co-borrowers.

Regarding the loan size, the maximum amount of student loan each year for undergraduate students was increased from 6000 RMB to 8000 RMB in 2014.

Regarding loan origination, HEIs and commercial banks are responsible for the HEI-based commercial bank loan, HEIs are mainly responsible for the HEI-based China Development Bank loan, county-level student financial assistance management center are mainly responsible for Home-based China Development Bank loan.

Regarding risk sharing, under the circumstance of HEI-based loan, Government and HEIs each shares half of the risk compensation fund.

Under the circumstance of home-based loans, Government bears the entire risk compensation fund.

Regarding repayment conditions, originally, the repayment period for HEIs-based loan is 6 years, meanwhile, the repayment period for home-based loan is 10 years. In 2015, according to the new policy, the repayment period for all student loans is extended to 20 years.

Regarding the loan collection, both HEIs and commercial banks are responsible for loan collection of HEI-based commercial bank loan, HEIs are responsible for loan

collection of HEI-based China Development Bank loan, county-level student financial assistance centers are responsible for loan collection of Home-based China Development Bank loan.

In addition, it is worth noting that the majority of student loans are supplied by home-based student loan scheme nowadays. Regarding the number of recipient, it contributes over 80%, regarding the total sum of student loans, it contributes over 90% (National Student Financial Aid Center 2013). Home-based student loan scheme is suitable for China's current specific circumstances. On the one hand, county-level student assistance management center uses traditional methods to collect information of rural students and their parents (co-borrowers) which is very difficult to get in developing countries and is vital for loan origination and collection, on the other hand, modern internet payment instrument (i.e. Alipay), which is very convenient for borrowers, is utilized in the loan origination and repayment. The operation of the home-based student loan has been quite successful till now. In 2012, the default rate is below 3%, which is lower than that of many student loans schemes in other countries.

4. Information regarding college costs and student financial aid

Information is a very important issue in the operation of student financial aid policy. In 2008, we (Loyalka, Prashant, et. al. 2013) conducted a cluster-randomized controlled trial (RCT) to find the causal relationship between information regarding college costs and student financial aid and some related outcomes. First of all, based on the baseline survey, we found that high school students usually overestimate the college costs, and the percentages of students knowing different types of student financial aid were relatively low, especially for green channel, only 27.6% knowing it. Regarding the results of the RCT, we find no evidence that college costs and financial aid information affects college choices. However, information definitely affects the likelihood that non-admitted students will retake the college entrance exam and the likelihood of receiving certain types of financial aid.

It is worth noting that our research was conducted several years ago. The situation of information in China has greatly changed recently. The major measures implemented by the government and institutions are as follows:

- (a) MOE has set up an online platform for national student financial aid information. (<http://xszz.chsi.com.cn/>)
- (b) China National Center for Student Financial Aid's official website has several columns regarding student financial aid, such as notice and announcement, policies, Q&A, video and pictures, etc. (<http://www.xszz.cee.edu.cn/>)

- (c) Many universities' Offices of Student Financial Aid also have official websites, which include all kinds of information regarding student financial aid. (e.g. Peking University, <http://www.sfao.pku.edu.cn/html/index.php>)
- (d) According to MOE's policy, students will receive a booklet regarding student financial aid when they get their letter of admission.

5. Conclusion

In conclusion, with the introduction of higher education cost-sharing policy and the implementation of grand expansion policy, China has gradually established its own student financial aid system. Specifically, 2007's policy issued by the State Council set up the institutional foundation for China's student financial aid system. Regarding the student loans schemes, home-based loan scheme plays the leading role in China's student loans market. With the introduction of special institutional arrangement of county-level student assistance management center and co-borrowers and the utilization of modern internet payment instrument, the operation of the home-based student loan has been quite successful till now. In addition, regarding the information problem, the situation has greatly changed recently.

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Chapter 5

Japan's Scholarship Programs Including Scholarship Loans: Overview and issues

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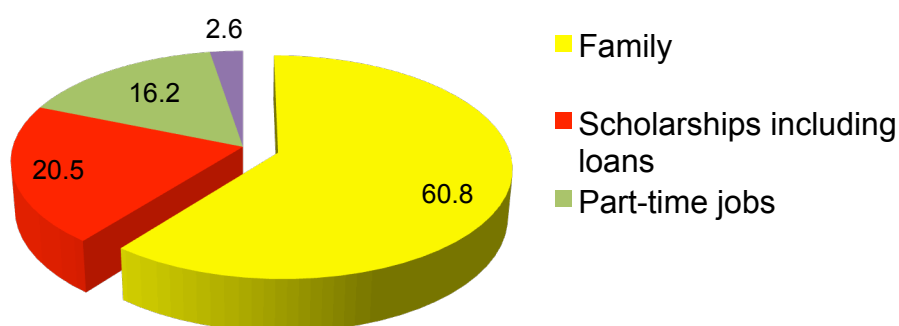
**Any opinions expressed here are those of the author and not those of Kyushu
University**

1. Overview of Japan's scholarship programs

1. The role of scholarship programs in maintenance costs of university students

The living (maintenance) expenses of Japan's university students are covered by their family members, mainly parents. This is contrasted with Britain where students are financially supported mainly by scholarships including loans. According to the survey on students' living expenses conducted by Japan Student Services Organization (JASSO) in 2012, income derived from scholarships including loans covered only 20% of the expenses of students including those at national, public and private universities. In comparison to British students whose scholarships including loans account for over 50%, this figure is extremely low. In Japan, the share of income from scholarships including loans is relatively small for each student. The number of recipients of scholarships including loans also remains relatively small in Japan.

Hereafter, "scholarships" will include scholarship loans.



Source: JASSO Survey on university students' lives, 2012.

http://www.jasso.go.jp/statistics/gakusei_chosa/12.html

Figure 17 Composition of university students' income in 2012 (%)

Table 2 University Students' Income and their expenses 2012**(1) Full-time undergraduate (Yen)**

| | National | Public | Private | Average |
|-------------------------|----------------|----------------|-----------------|-----------------------|
| Family | 996,200 | 838,000 | 1,288,400 | 1,215,200(60.8%) |
| Scholarship | 350,200 | 394,200 | 422,600 | 408,500(20.5%) |
| Part-time job | 280,800 | 321,800 | 332,000 | 322,600(16.2%) |
| Others | 46,300 | 45,600 | 52,400 | 51,000(2.6%) |
| Total income | 1,673,500 | 1,599,600 | 2,095,400 | 1,997,300(100%) |
| School fees | 673,700 | 682,100 | 1,319,700 | 1,175,500 |
| (Tuition fees) | 504,700 | 515,200 | 975,900 | 871,000 |
| Maintenance | 890,200 | 790,100 | 657,500 | 704,600 |
| Total expense | 1,563,900 | 1,472,200 | 1,977,200 | 1,880,100 |
| Number of students 2013 | (448) thousand | (127) thousand | (1987) thousand | (Total 2562) thousand |

(2) Post-graduate master course (Yen)

| | National | Public | Private | Average |
|-------------------------|---------------|---------------|---------------|----------------------|
| Family | 876,500 | 655,500 | 906,300 | 873,500(45.8%) |
| Scholarship | 524,400 | 539,500 | 596,400 | 551,800(29.0%) |
| Part-time job | 242,500 | 266,000 | 331,400 | 275,200(14.4%) |
| Others | 143,100 | 304,900 | 292,200 | 205,400(10.8%) |
| Total income | 1,788,500 | 1,765,900 | 2,126,300 | 1,905,900(100%) |
| School fees | 624,000 | 676,500 | 1,082,200 | 788,100 |
| (Tuition fees) | 483,000 | 502,400 | 808,500 | 598,500 |
| Maintenance | 1,013,900 | 887,400 | 846,800 | 947,600 |
| Total expenses | 1,637,900 | 1,563,900 | 1,929,000 | 1,735,700 |
| Number of students 2013 | (95) thousand | (11) thousand | (57) thousand | (Total 163) thousand |

(3) Post-graduate Doctor course (Yen)

| | National | Public | Private | average |
|-------------------------|---------------|--------------|---------------|---------------------|
| Family | 354,300 | 278,800 | 493,400 | 383,300(14.1%) |
| Scholarship | 1,131,000 | 892,400 | 802,500 | 1,040,900(38.3%) |
| Part-time job | 530,900 | 572,900 | 760,700 | 587,400(21.6%) |
| Others | 595,900 | 1,185,200 | 930,800 | 705,700(26.0%) |
| Total income | 2,612,100 | 2,929,300 | 2,987,400 | 2,717,300(100%) |
| School fees | 646,400 | 731,500 | 941,800 | 720,600 |
| (Tuition fees) | 418,700 | 465,000 | 578,800 | 459,000 |
| Maintenance | 1,404,500 | 1,377,700 | 1,390,800 | 1,399,700 |
| Total expenses | 2,050,900 | 2,109,200 | 2,332,600 | 2,120,300 |
| Number of Students 2013 | (51) thousand | (5) thousand | (18) thousand | (Total 74) thousand |

Source: JASSO Survey on University students' lives, 2012.

http://www.jasso.go.jp/statistics/gakusei_chosa/12.html

Ministry of Education, Culture, Sports, Science and technology (MEXT).

2. Overview of scholarships including loans in Japan

Organizations providing scholarships including loans in Japan are JASSO, local governments, Universities and non-profit organizations. Apart from these, some financial institutions supply loans for education.

Among these, JASSO plays a core role. JASSO is an independent quasi-governmental agency which was established in 2004 through a merger of four private foundations and the Japan Scholarship Foundation. JASSO provide students of universities, technical colleges, and higher vocational schools with scholarship loans. In 2014, the number of recipients will be 1.41 million. The total amount of loans is 1 trillion 174.5 billion yen (10.7 billion US dollars).

The scholarships provided by local governments, universities and foundations are a mixture of grant and loan styles. In 2010, the number of recipients is 480 thousand.

The individual scholarship is rather small so that its role in the entire scholarship programs is limited. The amount of scholarships given by universities in Japan is only 45.8 billion yen (0.4 billion US dollars) which is much smaller in comparison to the amount given by their US counterparts.

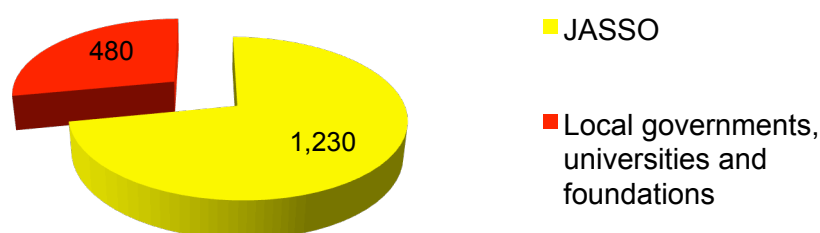
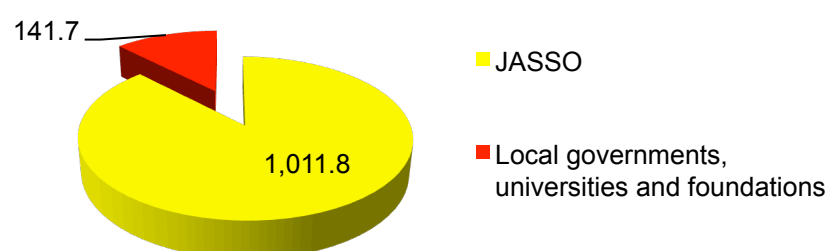


Figure 18 Number of Recipients by Providers in 2010 (thousand)



Source: MEXT, “Policy for Students’ Aids”, Committee on the Policy for Students’ Aids, August 29, 2014, p21.

Figure 19 Amount of scholarships in 2010 (billion yen)

Finally, the factual data of private financial institutions is not available for analysis. Only the data of Japan Finance Corporation, (which was established by a special law), is available. It provided 110 thousand loans amounting 153 billion yen (1.4 billion US dollars) in 2012. These are one-off loans providing high school and university students with an education fund up to 3 million yen or \$27,000. They are not monthly loans, unlike other schemes.

In the following sections, JASSO’s scholarship loans as a major program in student aids will be discussed.

3. JASSO’s scholarship loans

JASSO’s loans are comprised of two types, interest-free and interest-bearing. The criteria for eligibility for these loans are summarized in Table 3. The interest-free loans are

financed by government loans to JASSO and credited repayments. They are provided to those students who meet the academic and income criteria (including their families' income). The interest-bearing loan scheme is operated under lenient conditions with interest rate capped at 3%.

Table 3 Outline of JASSO's scholarship loans

| | Interest-free | Interest-bearing |
|-------------------------|--|--|
| Number of students | 450,000 | 960,000 |
| Total size of loans | 306.8 billion yen (2.8 billion US\$) including loans from the government 74.4 billion yen (0.7 billion US\$) | 867.7 billion yen (7.9 billion US\$) including treasury investments and loans 859.6 billion yen (7.8 billion US\$) |
| Amount of monthly loans | Options (For a student of a private university living with his/her family) 30 thousand yen (273 US\$),or 54 thousand yen (491 US\$) | Options 30,50,80,100 or 120 thousand yen (1,091 US\$) |
| Academic conditions | High school GPA 3.5/5 or higher University within top 1/3 | None in practice |
| Income conditions | 9.07 million yen or under(82,455 US\$) (private university, 4 members in family, living with family) | 12.23 million yen or under(111,182 US\$) (private university, 4 members in family, living with family) |
| Repayment | Within 20 years after graduation | Within 20 years after graduation |
| Threshold income | 3million yen(27,273 US\$) | |
| Interest rate | Nil | Ceiling at 3% (0% while in an university) |

Source: JASSO.

The loans are financed by JASSO's borrowing fiscal loans funds, scholarship loans from the government, and credited repayments. From 2007, a new system was introduced. The lower cost loans from private financial institutions are only used for the period that students are actively enrolled in their universities. This method is designed to reduce the amount of the interest subsidy from the government, as scholarship loans for students accrue no interest while students are actively enrolled. These loans from the private sector will be refinanced by scholarship loans from the government when graduates start their repayments. JASSO's borrowing fiscal loans are not guaranteed by the government.

The term of repayment is 20 years. The repayment starts 6 months after graduation.

The most important function of scholarship loans is to guarantee education opportunities. This function is fully realized when loans are secured before entering a university. This system is called reserved loans in contrast to selecting recipients among university students already attending university. Particularly, interest-free loans with stricter conditions than interest-bearing select about 40% of their recipients while they are still in high school. Eligibility for loans for post-graduate students is based on both students and their spouses' income. They are set forth at a lower level than those for undergraduates. For example, the upper income limit for interest-free loans for masters' students is 3.89 million yen (35,364 US\$). 31.1% of post-graduate students are granted interest-free loans while only 11% of undergraduates receive such loans. This difference can be attributed to the importance of fostering researchers and high-skilled experts at the post-graduate level. Since 2004 those post-graduate students with excellent academic achievements are exempted from repayments. Apart from these loans, the Japan Society for the Promotion of Science provides post-graduate students with financial aid. Currently, 4,700 doctoral students are the recipients of both monthly maintenance grants and research aid.

4. Issues in JASSO's scholarship loans programs

1. Total size of the programs

Table 4 Total size of JASSO's scholarship loans programs in 2012

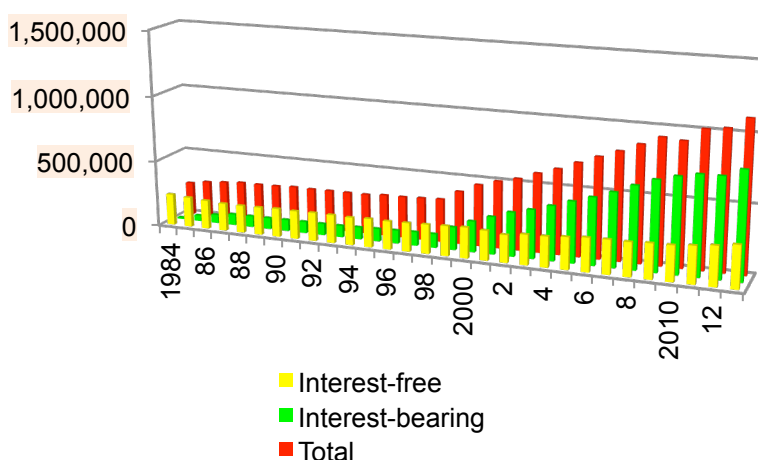
| | Total number of students (A) | Interest-free loans (B) | Interest-bearing loans (C) | Total (B+C) |
|-----------------|------------------------------|---|---|---|
| Undergraduate | 2,560,909 | 281,806 | 695,199 | 977,005 |
| Total amount | | 174.6 billion yen (1.6 billion US\$) | 600.6 billion yen (5.4 billion US\$) | 775.2 billion yen (7 billion US\$) |
| % of recipients | | A/B 11.0% | C/A 27.1% | (B+C)/A 38.2% |
| Post-graduates | 210,643 | 65,453 | 17,724 | 83,177 |
| Total amount | | 60.8 billion yen (0.6 billion US\$) | 18.3 billion yen (0.16 billion US\$) | 79.1 billion yen (0.76 billion US\$) |
| % of recipients | | B/A 31.1% | C/A 8.4% | (B+C)/A 39.5% |

Source: JASSO

Table 4 depicts the size of JASSO's scholarship loans programs in 2012. As shown in Table 4, the percentage of recipients of JASSO's scholarship loans is lower than those of England's 80% and America's 70%. The reason for such low percentage is explained by Professor Yano (1997) and Professor Kaneko (2005) as follows. In the post-World War II economic development in Japan, higher education was regarded as the most important factor in order to join the urban

middle class. This led to extremely high motivation among the general population for advancement to university. In addition to this, household income was evenly distributed and increased in a steady manner. Furthermore, the bond among family members in Japan is very strong so that parents are ready to sacrifice their own needs to send their children to universities. The other side of the coin is that parents have a tendency to avoid the interest-bearing loans in financing their children's education as they will become a burden on their offspring.¹¹

Figure 20 depicts the trends of the number of recipients of scholarship loans.



Source: JASSO.

Figure 20 Trends of the number of recipients in universities and junior colleges (Interest-free and interest-bearing loans)

JASSO's scholarship loans have been steadily expanding since the 1960s when the number of people pursuing higher education started growing. However, the pace of expansion was fairly slow until the conditions for interest-bearing loans were substantially eased in 1999. As a result, the number of loans did not catch up with the rapid growth of undergraduate students, and thus the percentage of recipients remained around 10% for many years.

In the 1990s, Japan's bubble economy burst followed by a long-lasting recession.

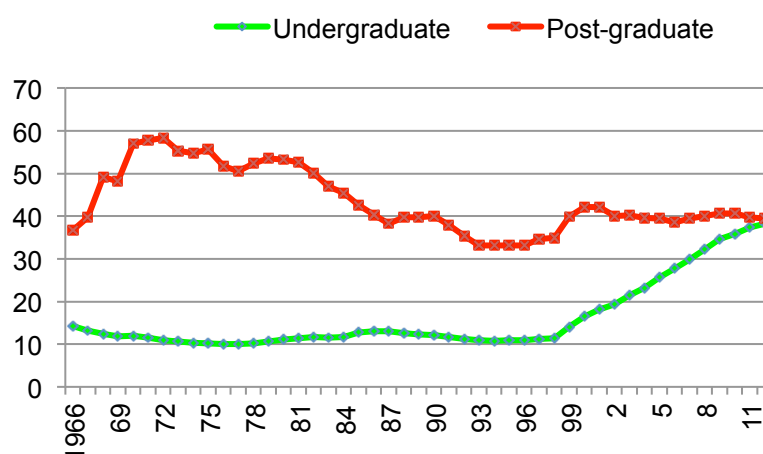
¹¹ Motohisa Kaneko, 2005, "Next focal point-Student scholarship and tuition fees," *IDE Higher Education in the Modern Society*, October 2005.

Masakazu Yano, 1997, "Socioeconomics of scholarships," *University and Students*, 388, MEXT.

On the other hand, the demand for scholarship loans expanded, as the advancement rate to higher education and its population increased.

In tandem with this trend, the government was looking for new investment fields for its fiscal loans funds by reviewing traditional areas such as roads. Medical and welfare services and education were identified as new and promising fields. Thus, during late the 1990s and early 2000s, interest-free loans financed by loans from the government failed to grow, while interest-bearing loans funded by treasury investments and loans expanded substantially. This trend continued in the following years to make the total number of recipients of both interest- free and interest-bearing loans in 2013 reach 3.4 times that in 1998.

As a result, the number of loan recipients among under graduate students reached 41% in 2013. However, this figure is much lower than those in UK, 80% and the US, 70%. (Figure 21)



Source: JASSO

Figure 21 Number of recipients among undergraduates and post-graduates

Number of recipients/number of students (%)

The question is if this low percentage will continue in the future or not. Japan has been experiencing a rapidly declining birthrate and an aging population. This brings about a massive financial burden on society due to increasing expenses for pensions, nursing care and medical services for the elderly. It is going to be increasingly difficult for parents to continue investing in their children's education instead of preparing for their own lives in retirement. It is also pointed out that the income gap among households is widening under long-lasting sluggish economic growth under which the number of part-time jobs are dramatically increasing in comparison to permanent positions. Such

circumstances will boost the demand for scholarship loans. In fact, the percentage of recipients is substantially increasing in tandem with the expansion of interest-bearing loans. There must be a strong demand for scholarship loans.

JASSO has to start designing a robust and sustainable scholarship loan system in preparation for further drastic expansion in the near future. The massive increase in recipients and decrease in full-time jobs will lead to insecure employment and unstable income. The repayment system has to be modified to fit such a situation so that university students can use the scholarship loans without much fear of debt. The income-contingent repayment system adopted by England and others serves as a good reference.

2. JASSO's income-contingent repayment system

JASSO introduced the income-contingent repayment system which was applied to interest-free loans in 2012. Repayments are deferred as long as the annual income remains below 3 million yen (27,000 US\$). Even after repayment starts, the deference is given when the income falls below the threshold again. Table 5 depicts the differences between JASSO's income-contingent repayment system and that of England.

**Table 5 Comparison of income-contingent repayment systems
Between JASSO and England**

| | JASSO | England |
|-------------------------|--|---|
| Type of loans | Interest-free loans | Tuition loans, Maintenance loans |
| Amount of repayments | Interest and principal in equal installments | $(\text{Income} - \text{£ } 21,000) \times 9\%$ |
| Threshold for deferment | 3 million yen | £ 21,000 (3.57 million yen) |
| Interest rate | Nil | Inflation rate + 0~3% |
| Written off | Death of recipients | 30 years or 65 years old |

Source: Masayuki Kobayashi, Yoshitaka Hamanaka, Liu Wenjun "Research on the Advancement to University and Financing of Educational Expenses-Survey on Parents of High school Students 2012" Japanese Association of Higher Education Research, 16th Conference, March 26, 2013.

The biggest difference is the coverage of loans. JASSO's income-contingent repayment system is applied only to interest-free loans which account for around 20% of total loans, whereas the English system covers entire loans including both tuition fees and maintenance loans.

One of the characteristic features in the English system is the adjustable amount of

repayments calculated as follows:

$$(\text{Income} - \text{£ } 21,000) \times 9\%$$

This contributes greatly to easing the anxiety of recipients, as all students anticipate instability in employment and income during their lives.

Furthermore, loans in the English system are written off 30 years after graduation or at the age of 65. This is another factor to alleviate the fear of debts.

In order to expand the higher education under the low-level of economic growth in Japan, the loan system has to be made user-friendly via adopting some of the excellent structures of the English system.

3. Lack of grant-type scholarships

JASSO's scholarships are in the form of loans. JASSO's predecessor, the Japan Scholarship Foundation was established in 1943 by a leading group of parliamentary members. They emphasized the following points in adopting loan-type scholarships:

- 1) The financial burden on the government should be minimized.
- 2) The responsibility of education should be shouldered by parents.

However, the demand for well-educated human resource grew as economic growth established its steady trend in the 1960s after the recovery from the post-war turmoil. Against this backdrop, a special scholarship loan scheme was introduced to exempt repayments in part. This new type of loan was provided to those who were selected by examination. These selected recipients were granted the entitlement to exemption when they entered university, thus this system was a de-facto grant under the loan-type scheme as a whole.

However, due to the recession after the oil-shock in the 1970s followed by the deterioration of the government fiscal deficit, the volume of the exemption was reduced, and the system itself was abolished in 1984. Currently, a third of post-graduate students are granted partial or whole exemption of repayment.

Another issue raised here is debt aversion. Particularly, those households in lower income bands tend to give up on sending their children to university, as they have fewer and limited access to information concerning the merits and outcomes of higher education and the risks of investment in higher education. This is an issue of imperfect information in Economics. The best way to cope with this issue is grant-type scholarships, targeting lower income households. The current financial situation in Japan makes it extremely difficult to introduce such a new scheme. However, it is worth introducing via scrapping other programs in education, as it is the most effective way to preserve social mobility.

4. Arrearage

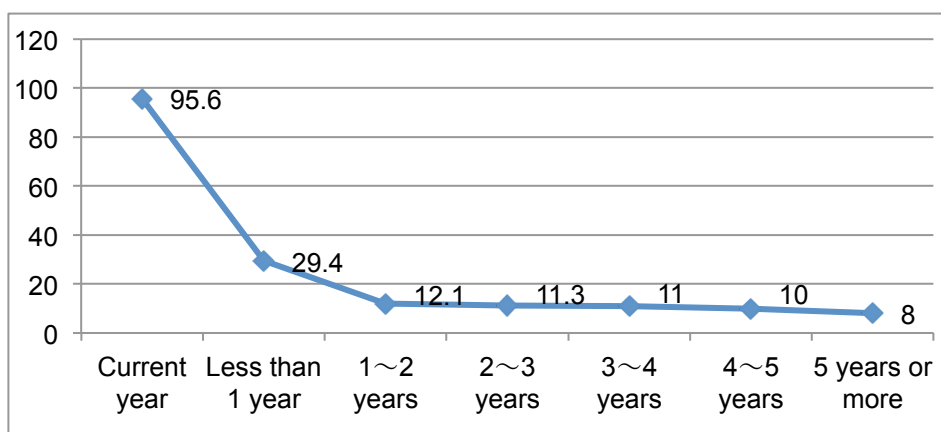
In JASSO's scholarship loans, interest and principal are repaid in equal installments over 20 years. The amount of monthly repayment is automatically deducted from the bank account of recipients. The recipients of scholarship loans are requested to open a bank account upon their graduation. The recipients are also required to register a guarantor and a surety liable jointly, or to participate in the institutional guarantee scheme by paying fees. The repayment starts 6 months after graduation, and is scheduled to finish in 20 years. An arrearage charge is calculated on the daily basis amounting to 5% (previously 10% until 2013) per year.

In case of overdue repayment, JASSO notifies over telephone up to three months. Guarantors and sureties are also notified after 2 months over telephone. Those recipients overdue more than 9 months are noticed of possible legal action through legal courts. The legal enforcement, (forcible seizure of salary), could be employed when the overdue repayment exceeds 9 months. If repayments are delayed for three months or more, the personal information of the loaner shall be registered with personal credit information organizations to prevent multiple debts. About 3.5% of new graduates fail to open the required bank accounts to start repayments. The total collection ratio for newly graduates is 96.5% in monetary terms.

Arrearages are accumulated year by year. Particularly, the volume of total arrearage has rapidly grown after the expansion of interest-bearing scholarship loans in 1999. The collection ratio of the delayed repayments deteriorates as the period of the delay gets longer. (Table 6, Figure 22)

Table 6 Collections of delayed repayments by period of delay 2012 (100million yen)

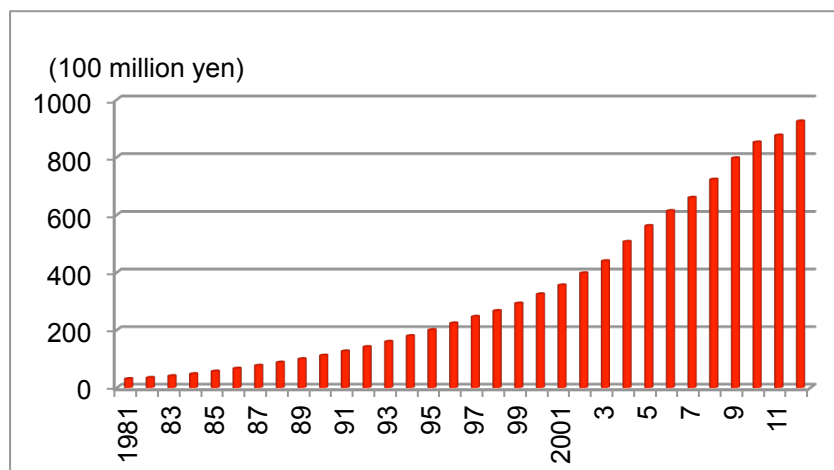
| Period of delay | Amount to be collected | Amount actually collected | Ratio (%) |
|-------------------|------------------------|---------------------------|-----------|
| 5 years or more | 310 | 25 | 8.0 |
| 4~5 years | 66 | 7 | 10.0 |
| 3~4 years | 80 | 9 | 11.0 |
| 2~3 years | 101 | 11 | 11.3 |
| 1~2 years | 120 | 14 | 12.1 |
| Less than 1 year | 176 | 52 | 29.4 |
| Total | 852 | 118 | 13.8 |
| Current year only | 4303 | 4113 | 95.6 |



Source: JASSO

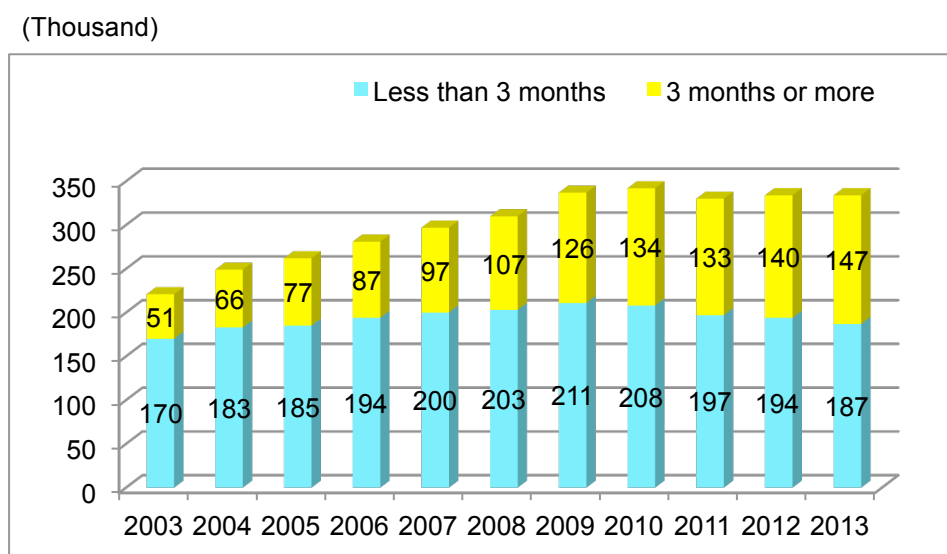
Figure 22 Collections of delayed repayments by period of delay 2012 (%)
Amounts actually collected/Amounts to be collected

Although the collection ratio for newly graduates remains at a relatively high level, the huge total amount of accumulated arrearage itself attracts criticism in society. The sustainability of the system of scholarship loans is often questioned. In fact, the accumulated amount and number of recipients in arrearage has been dramatically increasing. (Figure 23)(Figure 24)



Source: JASSO

Figure 23 Accumulated amount of arrearage



Source: MEXT “Policy for Student Aids” August 29, 2014, p23.

Figure 24 Accumulated number of recipients in arrearage (individuals)

In 2012, the accumulated amount of arrearage is 92.5 billion yen, 0.8 billion US\$, and the number of recipients in delayed payments is 330 thousands. This issue of arrearage has gathered intense attention in the society. JASSO has been making their utmost efforts to improve the situation.

The issue is the rapidly increasing costs in dealing with the arrearage, as the accumulated amount and the number of recipients in arrearage grow. The value for money in collecting arrearages has to be scrutinized.

In this connection, the collection system adopted in the English scheme could be a good starting point. In the system, employers withhold the amount of repayments of their employees who are recipients of scholarship loans. This withholding is done along with taxation at the source.

In order to eliminate the preventative factor of the expansion of scholarship loans, fundamental restructures in the collecting system at JASSO have to be implemented as soon as possible.

Chapter 6

Comments:

Issues on Student Financial Assistance Policies in Japan from an International Perspective

Yoshitaka Hamanaka

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Chapter 6

Comments:

Issues on Student Financial Assistance Policies in Japan from an International Perspective

Yoshitaka Hamanaka

1. Characteristics of Japan's scholarship policies

- **The major portion of financial assistance provided to students is JASSO's scholarship loans.**
 - ✧ As there are no publicly subsidized scholarships (grants) available, some express the view that Japan's financial assistance system for students is not extensive.
- **However, from an international perspective, as a "loan," the burden imposed on the user is not necessarily very heavy.**
 - As a principle, the loan is free of interest. (However, recently, the amount of interest-bearing loans has surpassed that of interest-free loans.)
 - Even in the case of an interest-bearing loan, the interest rate is fixed at a low level (the rate is linked to the FILP funding rate, and, if it exceeds 3%, the government provides a subsidy to cover the interest); no interest is charged while the student concerned is at school.
 - The term of repayment is twenty years.
 - Various measures for the extension of the repayment are available.

1.2 Characteristics of Japan's scholarship policies – historical background

- **"Loans" instead of "grants"**
 - ✧ Only students facing acute financial difficulties (coming from low-income families) are eligible.
- **Why "Loans" instead of "Grants"?**
 - ✧ This is largely due to the difficult post-war fiscal situation.
 - By using money recovered from existing loans as a source for new loans, the government's burden was contained to the utmost extent possible.
 - ✧ Also, since the establishment of the modern school system in Japan, the concept that costs for higher education should be borne by the beneficiary (the responsibility of the family) has established deep roots.
 - The concept of "a levy on the beneficiary" originated largely due to the weak and vulnerable fiscal situation during the early period of modernization in Japan.

(1.2 Characteristics of Japan's scholarship policies - historical background)

- **Under tight fiscal conditions and the principle of the beneficiary pays, to achieve**

- both economic growth and equality of opportunity simultaneously,**
- ✧ Concentrated investments and a low tuition policy in a small number of national universities.
 - Conditions for education (quality) and the capacity to select enrolling students were secured.
 - Achieved “equality of opportunity among students of high ability” (→ the principle of “the Promotion of Merit”)
 - Financial assistance provided to students supplemented this policy.
 - Both scholarship loans and tuition exemptions were made disproportionately available to students attending national universities.
 - **Meanwhile, supported by high economic growth, quantitative expansion was left in the hands of private universities (= the burden of tuition is on the household)**

Different conditions in “The Initial Period of Expansion of HE” (in the 1960s), when other advanced countries expanded higher education through public expenditure as part of a welfare state policy.

2. What is the current issue?

- **The current financial assistance scheme for students basically follows the traditional philosophy/framework that was formed around this period.**
 - ✧ Of course, in response to the quantitative expansion of HE, slight adjustments have been made (e.g., the introduction of interest-bearing loans (1984), and attempts to reduce the disparity between the number of recipients entering national universities and the number of those going to private universities)
 - ✧ The philosophy of “providing support to persons in financial difficulties” under the principle of “the Promotion of Merit” has not changed.
- **During the “Second Expansion Period of HE” (1990s~), the gap between the underlying philosophy of the system and social need gradually widened.**
 - ✧ The meaning of “equality of opportunity” changed with quantitative expansion.
 - From “equality of opportunity among students with high abilities” to “securing the opportunity for higher education according to the level of ability of the respective individual.”

2.1 What is the current issue? - recent trends

- **The discrepancy between the ideal and the reality has been dictated by the expansion of interest-bearing loans. (1999~)**
 - ✧ Academic standards and income restrictions were both extensively relaxed.
 - ✧ Currently, the ratio between those receiving interest-free loans and those receiving interest-bearing loans is 4:10.
 - Users have expanded into middle-income households.
 - The increase in tuition (= increased household burden) is definitely a factor, but there is also the fact that the use of low-interest loans, designed for households facing acute financial difficulties, is economically rational.
 - It is hard to define this as “the Promotion of Merit” for students with high abilities.
 - From the beneficiary-pays principle, doubts have been expressed as to

the necessity of providing substantial support using public funds.

2.2 What is the current issue? - readdressing the philosophy

- **A disparity in the university enrollment rate exists because of different levels of household income.**
 - ✧ Students giving up higher education for economic reasons do exist.
 - ✧ Due to the present knowledge-based society, the demand to move on to higher education (or post secondary education) will increase in students with mid-level academic achievements.
- The existing scholarship loan system cannot entirely satisfy any of the following aims: achieving equality of opportunity for low-income households, aiding middle-income households who have to pay for tuition, and public expenditure for higher education via support to individuals.
 - ✧ A scholarship policy that is adaptable to various social needs is required.
 - ✧ We need to readdress the underlying philosophy and design a concrete system that is compatible with such a philosophy.

3. Issues

3.1 Issue 1- Introduction of income-contingent repayments

- **The Cabinet decision “Regarding the Outline on Measures to Counter Child Poverty” was adopted in August 2014.**
- **Currently, we are at the stage of designing a way to implement ICR.**
 - ✧ Referring to examples in various countries, which is one of the purposes of this symposium.
 - ✧ Although “ICRs” are adopted in the UK and the US, the concepts underlying these two systems are completely different.

(A) The United Kingdom

The ICR comes as a set with a pay-later tuition system.

- In principle, everyone uses the income-contingent repayment system.
- After graduating, when the “benefits” of higher education have been accrued, a fixed percentage of these “benefits” are collected.
- The underlying concept is that the costs of higher education are borne by society as a whole but should be partially shared by the “beneficiary”.

(B) The United States

Measures to mitigate excessive loan burdens.

- Applicable to those persons who have selected the ICR option.
- The number of people who select this option is small due to the increase in the total amount repayable.

(C) In the case of Japan

We assume the new system will basically be similar to that in the US,

- As it is interest-free (or the interest rate is low), the cost of the installment payments is low and/or if payments are exempted after a certain period, the government’s financial burden will increase.
 - The system is not sustainable unless there are people who will be

- charged higher installment payments than are currently charged
 - The number of persons choosing the income-linked repayment model may be limited?
- There are not a few persons who hold the following view: if the benefits after graduation are small, this is due to a lack of effort on the part of the individual concerned, and/or “people who should not have enrolled are moving on to higher education” (excessive expansion of higher education)

→ What is the situation in other countries?

➤ **Relationship between ICRs and equality of opportunity.**

- ✧ In Japan, the purpose of the introduction of ICRs is as follows
 - “easing the future anxieties of students coming from financially distressed backgrounds, and enabling students to enter school without worries.”
 - To counteract the tendency of low-income earners to experience “loan aversion” or “risk aversion.”

→ **Will the introduction of ICRs contribute to the equality of opportunity?**

→ **What is the situation in other countries?**

3.2 Issue 2 – The pros and cons of grants

- **Almost all the political parties in Japan agree on the introduction of grants.**
 - ✧ However, there are no funds available at the moment for these grants.
- **Issues that need to be cleared in introducing grants.**
 - ✧ Eligibility
 - Should it be the same as the current loan scholarships? That is, financial difficulties and superior academic achievements
 - Even now, most academically superior students advance to universities.
 - Will it contribute to achieving equality of opportunity?
 - If the criteria are solely limited to financial difficulties, can we attain a social consensus in Japan where there is a tradition based on the principle of “the Promotion of Merit”.
 - ✧ What types of costs are eligible for payment
 - Tuition or cost of living? Or both?
 - From a beneficiary-pays perspective, should tuition be borne equally?
 - Is it similar to or different from tuition exemption?
 - ✧ Methodology
 - No-need-to-pay-back scholarships, or conditional exemption from repayment?
- **It is quite clear that this is more desirable as a measure for the redistribution of income . . .**
 - ✧ Merits and demerits compared to methods other than paid scholarships for higher education?

3.3. Issue 3 – Tuition/scholarship policy and the quality of higher education

- **The situation is the same in each country. It is difficult to meet the increasing costs of HE with public funds. However, the methodology for sharing costs is different for each country.**

(A) United States

The government is inducing cost-sharing by expanding federal loans and introducing various tax advantages

- The quality of education has improved through competition between universities.
- As a result of an upsurge in tuition, the use of loans has further expanded, and the excessive burden has become a social problem.
- On the other hand, as a result of the expansion of loans, anyone can afford tuition for now. This results in an expansion in the number of for-profit universities, leading to the issue of a decline in quality and thus calls for stronger monitoring of quality by the federal government

(B) United Kingdom

The burden of the cost of education has moved from institutional subsidies to tuition.

- Based on the assumption of the following scenario; expansion in size (quota) → resolving excess demand → competition between universities → improvement in quality
- To ensure fair competition, universities must strictly comply with the need for information disclosure.

(C) China

Problems are likely to erupt if the scale expands further?

(D) Japan

Essentially, the ratio of private funding is large and it is difficult to implement a significant rise in tuition, so

→ excess demand will continue,

→ it will not lead to competition between universities and an enhancement in the quality of education.

→ In addition, information disclosure is insufficient.

- What is the role of the financial assistance policy for students if one has the aim of enhancing the quality of higher education?

Chapter 7

Conclusion:

Lessons for the reform of student financial assistance policy in Japan

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Chapter 7

Conclusion:

Lessons for the Reform of Student Financial Assistance Policy in Japan

Masayuki Kobayashi

In this conclusion, I will sum up the lessons for the reform of student financial assistance in Japan and provide policy options considering the suggestions in the previous papers. I will choose only a few issues that we will have to discuss further if we wish to reform the student financial assistance scheme, although there are many issues that we have already discussed.

We have to note that each country has its societal, cultural, economic, historical, and political background, and differences in education reflect these differences. However, each country faces the same challenge of the reform of higher education, especially that of tuition fees and student financial aid. In this conclusion I will try to focus on the common tasks and challenges.

1. Cost sharing in higher education

Obviously it is more difficult for countries to sustain the costs of higher education with public funds, although there are a few exceptions to this, such as the Nordic countries. The mega-trend of cost sharing has been shifting from public to private, especially from parents to students. Japan is the leading country in this mega-trend.

However, this shift causes some serious problems. The costs of higher education are shared by households while tuition fees are rising in Japan. This means that the burden of the costs of higher education has been becoming heavier and heavier, particularly for low income families. This affects the accessibility and affordability of higher education for these families.

Besides this, the loan burden and loan aversion are very serious problems in many countries. Therefore, student financial aid programs have become more important than ever. On the other hand, the quality and size of higher education should be maintained and enhanced through a mixture of public and private funding. This might lead to a

misunderstanding about cost sharing if we only think about tuition fees without considering other factors. In particular, I underline the need to consider the combination of tuition fees and student financial aid when we examine this cost-sharing issue.

2. Access and affordability

Accessibility and affordability are the most important issues in higher education. Each government has made substantial efforts to improve these aspects while having to confront ever rising tuition fees and decreasing public subsidies to higher education. The focus is on student financial assistance for under-represented groups. Nonetheless, we still find inequality of access to higher education in each country. This means that we need more reform of our student financial assistance schemes.

3. The reform of student loan programs

In this report, authors discuss the reform of student financial assistance schemes, particularly with regard to income contingent loan repayments (ICRs) and financial literacy.

The authors of these papers stress that ICR is a device for insurance and for smooth consumption without heavy credit constraints. They stress that ICRs are effective and equitable when it comes to reducing the risk of borrowing and the need to mitigate the burden of loan repayments, especially for borrowers with low incomes.

We have to consider many issues when we reform the income contingent repayment scheme in Japan. Here I will focus on only two.

1. Interest subsidies or interest-free loans

One big issue is the interest rate of the student loan, particularly that of income contingent loan repayments (ICRs). In his paper, Professor Barr insists that subsidized loan interests should be abolished. His argument is that these subsidies are not only very expensive but also that the beneficiaries are mainly middle class. He seems not to care about the fact that the amount of interest that borrowers repay is more for borrowers on low incomes because the repayment period is much longer for them. He argues for making repayment periods a bit longer.

However, the argument for the reform of student loans in Japan has been going in entirely the opposite direction. We have two types of student loans, that is, interest-free loans and low-interest loans. The interest-free loan program was established in 1944 and the low-interest loan program was introduced in 1984. Since 1999, the volume of low-interest loans has been increasing dramatically, while that of interest free-loans has been increasing gradually, as was seen in the introduction and in Shibata's paper. Almost everyone, the Minister of Education, the members of the Diet, major political parties and researchers advocate a change from low-interest loans to interest-free loans. The main

reason is the sum of the interest is much more in the income contingent repayment program for low income borrowers who have to repay over a longer period. We will now consider Barr's argument for the reform of the student loan programs in Japan.

2. The amount of the loan

Barr insists that the loan should be large enough to make higher education free at the point of use. Therefore, it should cover not only tuition fees but also the living costs of higher education. However, most arguments for the reform of student loans in Japan move in the opposite direction here, too. They argue that we should limit the maximum amount of the loan a student can borrow to prevent over-borrowing. The default rate might be higher, particularly with ICRs, as the amount of the loan is higher. Barr's argument is that with ICRs the amount of the loan makes the repayment period longer but it does not affect the monthly repayment and default rate. We will discuss this issue further with respect to the reform of the student loan scheme in Japan.

4. The new income contingent repayment plan

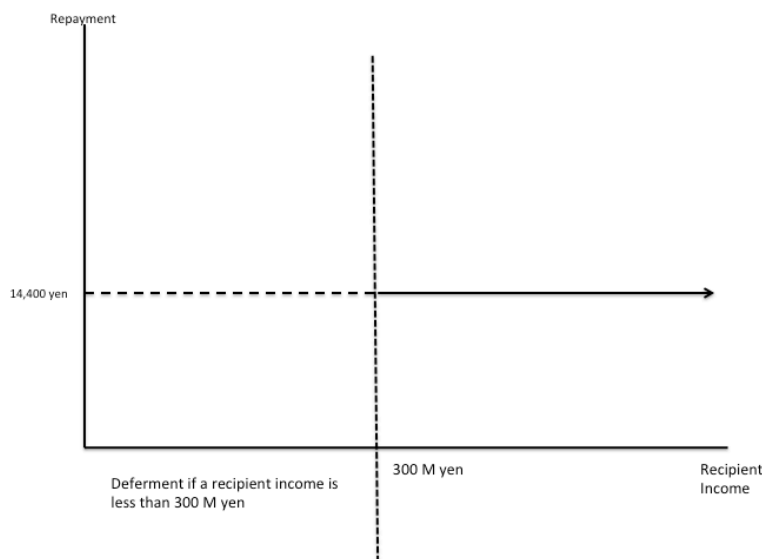


Figure 25 The income contingent repayment plan of JASSO interest-free student loan of 2012

The ad hoc committee on the income contingent repayment plan advocated the new ICL plan March 2016. Figure 25 shows the present repayment plan of JASSO interest-free student loan. The amounts of borrowing are decided by the type of HEIs and residence. The case of Figure 25 is a plan for a undergraduate student attending private university from home. This plan is called “income contingent,” but, as a matter of fact, it has only deferment of repayment if the borrower's income is less than three million yen though the

deferment period is unlimited. Furthermore, this plan is only adapted the borrower's family income is less than three million yen at the time of application. Thus, it is a repayment plan for low income family. The amounts of repayment are *not contingent* on borrower's income.

On the contrary, the new repayment plan is truly "income contingent" as is shown in Figure 26. The repayment rate is nine percent of the borrower's taxable income, and the deferment (maximum ten years) is also adapted when the borrower's income is less than three million yen. A borrower can choose whether the present repayment plan or the new repayment plan by the end of borrowing. This repayment plan does not apply to low-interest student loan.

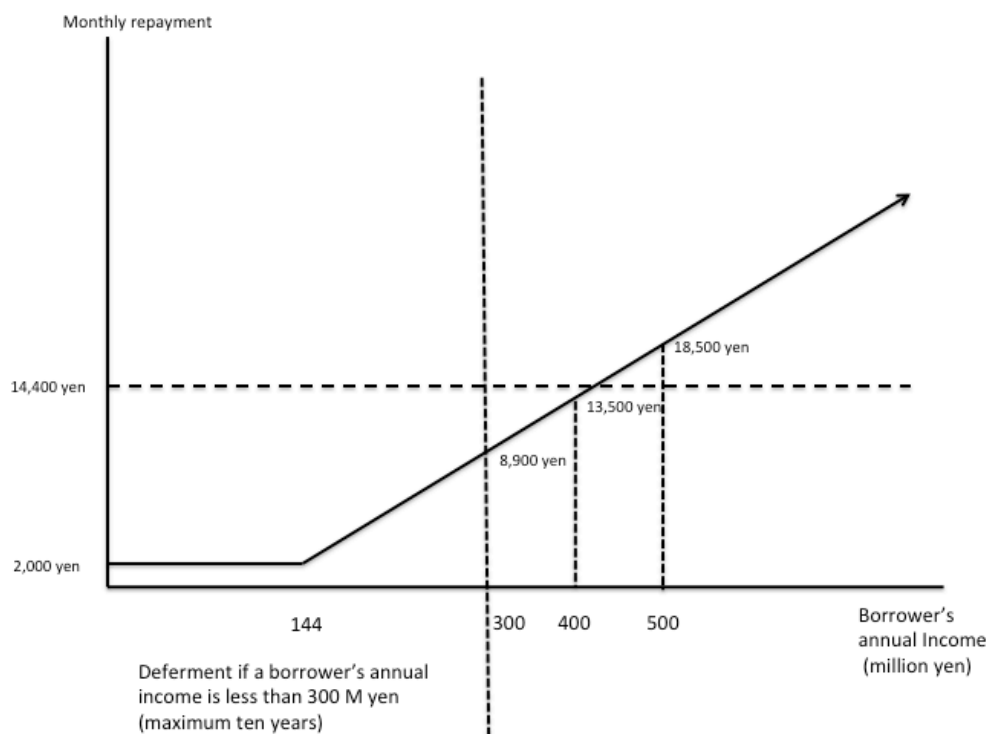


Figure 26 The new income contingent repayment plan of JASSO interest-free student loan

It is too early to evaluate this new repayment plan. One thing certain is that the guidance of this new plan is extremely important because a borrower must choose one. We will continually investigate the consequences of this new repayment plan to improve the repayment plan in the future.

5. The information gap and the early management of financial literacy

In this report, the authors of each paper deal with the information gap and stress the importance of early management for providing adequate information and knowledge of student finance issues. Each country has made efforts to improve the financial literacy of parents and students: e.g., the Widening Participation Program in England, compulsory guidance for students in the USA, and loan calculators in England, the USA and Japan. However, the authors all agree that we should facilitate to a greater and greater extent the dissemination of knowledge and information before students enroll in higher education. They say that, in order to reduce the information gap, as well as providing better information and knowledge, we have to make student financial assistance simpler, especially with regard to loan repayment schemes.

6. Grants or scholarships for undergraduate students

There are few people who do not want to introduce grants for undergraduates in Japan. However, the financial authority argues that the public finance situation does not allow for this. We still need to argue our case. To ensure the effective use of public funds, grants should be well-targeted and effective. The criteria for eligibility for grants and scholarships are the focus of the discussion; need-based, merit-based, or both, the last being the traditional criterion for student loans in Japan. If this is done, they will contribute not only to equality of access but also to the efficient use of public funds. Thus, we will try to acquire the understanding of the taxpayers and the relevant financial authority.

7. Perspectives

We have been discussing the issues of student financial assistance programs while considering their background. We have found common characteristics among the problems these programs face: access, cost-sharing in higher education, loans versus grants, ICRs to improve the situation regarding loan debt and loan aversion, and so on.

Each chapter reveals that each country has been trying to reduce disparities in educational opportunity in the face of very tight public finances. Furthermore, some Japanese universities and colleges have implemented new policies to lessen the burden on the household through various means such as grants for undergraduates and/or waiving tuition fees for students from low-income families. This kind of activity may change the situation of financial aid in Japan.

The lessons provided by the authors will be very helpful in obtaining plentiful suggestions for the improvement of tuition fees and student financial aid in Japan as well as in other countries, particularly for those who are trying to introduce ICR schemes. It is our hope that these will bring about changes in this area in the near future

I underline that more evidence is needed concerning the reform of student financial assistance schemes in Japan. We will collect data and analyze our findings to acquire evidence. Our research project has provided the results of the new nationwide survey on and equality in educational opportunities, as we mentioned in our introduction. We have found that we face a loan aversion problem and a low awareness of student loans. Simultaneously, we have been surveying educational reforms, particularly policies on tuition fees and student financial aid programs in other countries. These are very suggestive, and we will continue our comparative studies in order to acquire evidence about the reform of student financial assistance policy. We hope this report will contribute to efforts for reform.

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