Skills Research Initiative
Initiative de recherche sur les compétences

Recent Changes to Student Loan and Tuition-Setting Policies in Post-secondary Education: Comparing Australia, New Zealand and the United Kingdom

Saul Schwartz (Carleton University)

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Abstract

Programs that allow students to repay their student loan on an income-contingent basis now exist in several countries, including Australia, New Zealand and the United Kingdom. From time to time, the idea of creating a Canadian income-contingent repayment program is raised in policy discussions. The issue of how tuition fees are set is related to income-contingent loan repayment both historically — income-contingent loan programs were introduced along with significant changes in tuition fees — and politically — some see the introduction of an income-contingent repayment loan program as an excuse to raise tuition fees. This report focuses on the empirical experience of Australia, New Zealand and the United Kingdom with their income-contingent loan programs and with their attempts to decentralize fee setting. A limited set of lessons for Canada is raised and discussed in the concluding section.

Résumé

Des programmes qui permettent aux étudiants de rembourser leurs prêts d'études selon leurs revenus existent maintenant dans plusieurs pays, y compris l'Australie, la Nouvelle-Zélande et le Royaume-Uni. L'idée de créer un programme de remboursement selon le revenu au Canada est soulevée de temps en temps dans les discussions en matière de politiques. La question portant sur la façon dont sont établis les frais de scolarité est liée au remboursement des prêts selon le revenu sur le plan historique — des programmes de remboursement selon le revenu ont été créés en même temps que d'importants changements ont été apportés aux frais de scolarité — et sur le plan politique — certains estiment que l'on se sert de la création d'un programme de remboursement des prêts selon le revenu pour augmenter les frais de scolarité. L'auteur se concentre sur l'expérience empirique de l'Australie, de la Nouvelle-Zélande et du Royaume-Uni qui ont des programmes de remboursement des prêts selon le revenu et qui ont tenté de décentraliser l'établissement des frais de scolarité. Dans la conclusion, l'auteur présente et explique un certain nombre de leçons pour le Canada.

I. Introduction

At the beginning of 2006, three countries that are historically close to Canada — the United Kingdom, Australia and New Zealand — will have adopted a system of post-secondary finance that includes tuition fees that can be set, to a limited extent, by post-secondary institutions and a system of student support that makes student loans available on an income-contingent repayment basis. Both facets of these systems can be seen as movements toward a market-based system of financing post-secondary education.

Montmarquette and Boisclair (2004) argue for such a market-based system as the efficient way to link the labour market to the post-secondary education system. Tuition fees would cover the full cost of the schooling received and government-sponsored income-contingent loans would allow worthy students "from less fortunate backgrounds" to attend. Noting that Australia has long had an income-contingent loan system and that the United Kingdom would have one in place for 2006, Montmarquette and Boisclair proposed that the Skills Research Initiative examine two questions related to those plans:

(1) How do the British and Australian income-contingent loan programs perform with respect to their goals?
(2) Which elements of these programs could be implemented in the Canadian context?

The request for proposals arising from Skills Research Initiative also emphasized the link between post-secondary education and the labour market:[1]

> The post-secondary educational system has been and will continue to be the most significant source of workers bringing new skills to the economy. The adequacy of the supply of skills for innovation depends on whether the labour market furnishes appropriate signals (in terms of expected labour market outcomes) to attract potential students in sufficient numbers to the appropriate fields of study, on whether students (and their parents) respond to these signals, and on how post-secondary institutions respond to signals from students (demand for various programs) or to signals from the labour market.

One part of the proposed investigation of these relationships between the labour market and post-secondary education, elaborating on the questions suggested by Montmarquette and Boisclair, involves an international comparison of student loan and post-secondary financing systems.[2] In particular, the experience of Great Britain and Australia with income-contingent loans was to be examined as was tuition-setting policy in New Zealand and Great Britain. In this report, we perform that international comparison, expanding the scope of the question somewhat because all three countries mentioned — Australia, New Zealand and the United Kingdom — have changed both their student financial assistance programs and their tuition-setting practices in recent years.

[1] See Industry Canada (December 2004), p.3.
[2] Ibid., p. 5.

Another part of the international comparison is to examine, to the extent possible, whether the changes to student aid and to tuition-setting practice have affected overall post-secondary participation and, specifically, the participation of students from low-income families.

The report is organized as follows: Section II, drawing largely on the work of Nicholas Barr of the London School of Economics, presents a synopsis of the economic theory that justifies practical alternatives in student financial aid and tuition-setting practices. While the Barr analysis supports a movement toward higher tuition fees and toward a particular kind of income-contingent loan program, it differs from the analysis of Montmarquette and Boisclair in several important ways. A fair summary might be that Barr (and the Australian analyst Bruce Chapman) support increasing the extent to which market forces operate in post-secondary education but would not move as far toward a pure market system as Montmarquette and Boisclair seem to be willing to go.

Following the synopsis of the underlying theory, Section III turns to a description of tuition-setting practices in the three countries. All three have moved, over the past 15-20 years, from systems requiring no tuition fees to systems that now demand significant fees. That said, current tuition fees fall far short of covering the full cost of post-secondary schooling and there may be limited scope for further increases in the near future. Section IV describes the income-contingent loan programs that have been in place in Australia and New Zealand since 1989 and 1992, respectively. The proposed UK system and its predecessors is also described. Section V reviews the evidence on post-secondary participation in the wake of the changes. The majority of that evidence is Australian since only limited study of the issue has taken place in New Zealand and the UK system has not yet begun operations.

In the last section of the paper, the current Canadian student financial aid system is briefly described as are current Canadian tuition-setting practices. More importantly, the section discusses the desirability and feasibility of Canada moving in the direction that Australia, New Zealand and the United Kingdom have moved.

II. A Synopsis of the Underlying Theory

For many years now, there has been an on-going debate about how post-secondary education should be organized and funded. One part of that debate centres around two different models of higher education that Nicholas Barr calls the "Scandinavian" model and the "Anglo-American" model.[3]

The Scandinavian model is characterized by low or non-existent tuition fees and often includes living allowances for all students. Individual post-secondary institutions are similar to each other in terms of their funding and their relative status. Crucially, a relatively small proportion of the relevant age group is enrolled in post-secondary education. The Anglo-American model is characterized by tuition fees of some magnitude (though usually less than half of the cost of the education provided), targeted student aid and a wide range of post-secondary institutions, including highly-selective world-class research and teaching universities as well as low-cost schools serving local populations. The Anglo-American system is usually associated with mass higher education, with relatively high proportions of the relevant age group enrolled in some form of higher education.

By and large, Canadian post-secondary education has followed the Anglo-American model. Non-trivial tuition fees are in place, student aid is targeted to students from low-income families and post-secondary participation rates are among the highest in the world. However, unlike the American situation, there are few private universities and provincial funding formulas have implied that universities are similar in funding and status. That said, some universities — the University of Toronto and McGill University are two examples — believe that demand for places in their programs is sufficient to justify charging higher tuition fees. According to the relevant institutions, these higher tuition fees would help them expand their research activities and make it more likely that they could rank with other world-class institutions.

This report focuses on international experience with two facets of the Anglo-American model — allowing tertiary institutions to set their own fees and providing income-contingent repayment loans to help students pay the tuition fees and other costs of post-secondary education. It is important, however, to realize that these two features assume the existence of an Anglo-American model of higher education. In a Scandinavian model, there would be no fees charged and therefore no need for students to borrow.

Before turning to the two ideas that will occupy our attention in this report, it is worth highlighting an important maintained assumption. The report will assume that the contemporary economy demands mass participation in higher education and that there must be a diversity of institutional types; it will further assume that mass participation demands the continued existence and development of the Anglo-American model in Canada. The justification for these assumption is the belief that mass higher education is simply too expensive to be entirely provided by the state, even if other arguments for the

[3] See Barr (2001), Chapter 2.

Anglo-American system are rejected. When other countries such as Australia, New Zealand and the United Kingdom followed the Scandinavian model, as they did before the 1990s, their rates of post-secondary participation were quite low relative to those of Canada and the United States. When those countries decided to move to mass participation, they immediately introduced significant tuition fees. That is, mass higher education will be assumed to require substantial non-government resources and the most important source of such resources will be students and their families.[4]

That said, it is important to recognize that many in Canada do not accept that the Anglo-American model is appropriate. The Canadian Federation of Students (CFS) is quite clear, for example, that it prefers that tuition fees be abolished and generous support provided for students and for the universities.[5] Also worth noting from the beginning is the CFS assertion that specific reforms (such as the introduction of income-contingent student loans) are part of a broader reform agenda rather than narrow administrative program alterations. The introduction of income-contingent loans would likely be part of the on-going evolution of the Anglo-American model in Canada and would be associated with higher and more variable fees.

The theoretical discussion in the next section follows the logic of the argument presented in Chapters 10-14 of Nicholas Barr's *The Welfare State as Piggy Bank*. Barr's conclusion is that contemporary higher education must allow market forces to play an important role in the funding and regulation of the system while at the same time allowing significant state intervention.

Should markets play a role in post-secondary education?

A central assumption of textbook versions of microeconomic theory is that both consumers and producers are very well informed about the markets in which they operate — that is, they have perfect information. They know a great deal about the good or service being sold, they know about the costs of producing it and they know for how much it can be sold. In absence of perfect information, economic theory suggests that market provision of goods and services is more efficient than government provision:

(a) the better is consumer information;
(b) the easier it is for information to be improved;
(c) the easier it is for consumers to understand information;
(d) the lower are the costs of choosing badly;
(e) the more diverse are consumer preferences.

As an example of a good that is most efficiently produced in a market, consider food. With respect to criteria (a)–(e), consumers know a great deal about food (knowledge gained from long experience) and it is not hard to obtain easily-understood information if

[4] Funds could conceivably also come from employers. Employers are unlikely to be willing to support non-specific training, however, and we therefore focus on students and their families.

[5] See Canadian Federation of Students (2005).

desired. By and large, the consequences of making a mistake are small and we are all quite different in our tastes. That said, there is still a vital role for government in providing information and in regulating the production and sale of food. All in all, though, it makes sense to provide food primarily through markets. Equity considerations are typically handled by giving income support to those unable to pay for food.

As an example of a good that is most efficiently produced outside the market system, consider health care. Should a serious health problem arise, most people are unaware of the best solution to the problem and would immediately seek the help of a medical professional. Even if they try to find out more about their health problem, it is not easy to find and understand the relevant information. If a mistake is made — either by the sick person or by the medical professional — the consequences can be catastrophic. And, finally, "good health" has roughly the same meaning for all of us. All in all, health care should be provided primarily by the government since markets may not work well.

What about post-secondary education? Is it more like food or more like health care? In principle, students can be well-informed. They are old enough to understand the vast array of information that is available, they can get more information if they wish and they know their own capabilities. Moreover, information can be improved through high school courses (like the Ontario high school "Careers" curriculum). The costs of choosing badly are not very high. If you enroll in a science degree and that turns out badly, it is easy to switch programs or to switch institutions. And it is clear that students vary widely in their preferences among educational programs.

The counter-argument is that while students *could* be well-informed, they generally act passively. Many students have no clear idea of their post-secondary options and simply makes choices on the basis of what their friends are doing or what their parents ask of them. Moreover, some (including Barr) argue that potential students from low-income families are especially prone to being ill-informed about post-secondary education.

Because it focuses on two features of the Anglo-American model, the implicit assumption underlying this report here is that post-secondary education is more like food than health care, implying a role for the market mechanism.[6]

One immediate implication of the introduction of market forces into post-secondary education is that the resulting system must have a diverse set of institutions. Because students and their families will bear some non-trivial proportion of the costs, they will (and already have) demanded choice among institutions. The days of a common curriculum, unrelated to the job market, are long past. Some students are interested into narrow vocational programs that are directly tied to the job market; others seek broad liberal arts degrees that have no obvious connection to the job market. Some are willing to commit many years to post-secondary education; others are looking for shorter programs that allow them to move quickly through school and into the job market. In the

[6] The same arguments imply that primary and secondary education should be provided primarily by the state rather than by the market. Small children and their parents are not likely to be well-informed about the nature of primary education and the consequences of a mistake can be quite devastating for small children.

Anglo-American systems, we therefore see that consumer choice has led to a diverse set of institutions. Some will seek world-class universities and be accepted by them; others will either choose universities of lesser quality or be constrained to them by their high school performance.

Once there is a diverse set of institutions, the question of differential fees must arise. Not only will the demand for places vary by institution, but the costs faced by the diverse set of institutions will vary considerably. This feature of the system implies that:[7]

> …universities need to be differentially funded to take account both of a particular institution's costs and of the demand for places … [a] mass system – and *a fortiori* a mass system in an increasingly complex world – needs a funding regime in which institutions can charge differential prices to reflect their differential costs.

In theory, then, mass education within an Anglo-American would be characterized by competition among suppliers of post-secondary education for fee-paying students. The nature of the competition might be little different than competition in other markets. Different kinds of schools would be producing different products with different prices. In practice, as we will see, allowing universities to compete has not resulted in the competition that theory suggests might develop.

Because we have assumed that a system of mass post-secondary education is too expensive to be fully funded by the state (even though we also assume that the government must continue to be an important source of funds), the next question is who should pay for the share of post-secondary costs that are not paid by the state. A plausible answer is that students and their families should pay these costs. The reason is that students surely benefit directly from their education and should therefore pay at least part of the cost. Equally sure is that post-secondary education confers benefits on the society as a whole and that the state should also bear part of the costs. That said, there is no agreement on how the costs should be shared between the state and the student. If students are to pay any part of the cost, however, another question is how they will pay.

Most agree that the provision of student financial aid is a key role for government in a modern post-secondary system. The alternative would be a student loan system that is entirely private. Such a system would be unacceptable since access to it would be limited to those who could provide adequate security for the loans. Lacking collateral, many students from lower-income families would be denied loans and therefore denied access to post-secondary education to the detriment of themselves and of society as a whole. Government-subsidized loans are therefore an essential element of the Anglo-American system. The form of the loans is the subject of a later section. Moreover, the argument that students from lower-income families do not have the same information as do students from higher-income families implies that government grants to lower-income student should be provided.

[7] Barr (2001), p.192.

To summarize this section, the assumption that contemporary economies require a diverse system of mass education is assumed to imply the need for an Anglo-American system that is funded partially by the government and partially by students through tuition fees. Student fees can come from parents, from the students' future income (in the form of student loans) or from government grants to lower-income students. Fees should be set by the institutions themselves since they are better placed than any central body to assess student demand and institutional costs.

Based on the available evidence, it would seem that Australia, New Zealand and the UK have accepted the broad outlines of the system sketched above although each country has varied from it in important ways. In the two next subsections, we discuss two related issues. First, we briefly discuss the argument that low tuition implies high government subsidies which are in turn regressive because the children of higher-income parents are disproportionately likely to enroll in post-secondary education. Second, we begin the discussion of income-contingent student loans by comparing mortgage-style loans (as currently exist in Canada and the United States) to income-contingent loans (as currently exist in Australia, New Zealand and the UK).

Is it regressive to charge no tuition fees?

A crucial element in the political arguments about the transition from the Scandinavian model to the Anglo-American model is the argument that *not* charging tuition fees represents a transfer from low-income families to high-income families. If a post-secondary system is entirely funded from tax revenues, then families that pay taxes but whose children do not enter the post-secondary system will derive no direct benefit from it. Since there is a clear and positive correlation between family income and the likelihood of post-secondary enrolment, the argument is consistently made that low-income families are paying taxes to educate children from high-income families. Indeed, in the Australian and UK debates around the introduction of tuition fees, this argument was a central plank of government arguments in favour of those policies.

The question of whether the poor are paying for the education of the children of the rich is a long-standing empirical question in economics. The complication is that, to the extent that the tax system is progressive, higher-income families pay a greater proportion of their income in taxes than lower-income families. For example, very low-income families typically have very low tax liabilities so it is clearly not their taxes that are funding the education of the high-income students. In the end, if there is substantial progressivity in the tax system then it may be true that the children of the high-income families are more likely to get a free post-secondary education but it may also be true that their parents have paid their share in the form of higher taxes. Alternatively, if the tax system is not progressive, then high-income families will not be paying proportionately higher taxes and the equity argument in favour of tuition fees might be more reasonable.

The Australian government of the late 1980s (and the government commission appointed to study fee-setting alternatives) argued strongly that the policy of having no tuition fees was regressive and that instituting tuition fees would be a step toward greater equity among income classes. In contrast, Curtin argues that the top 20 percent of Australian

taxpayers contribute nearly 60 percent of net tax receipts so that the regressivity argument in favour of tuition fees is not valid.[8] Moreover, he argues that the Australian tuition fees constitutes "double taxation" since even without tuition fees university graduates essentially pay for their education by paying higher taxes.

Given that the regressivity of various educational funding formulas has been a controversial and unsettled issue in economics for so many years, it is unlikely to be resolved in the near future. The point to recognize here is that the argument that introducing or raising tuition fees is a step toward a more equitable distribution of income should not be accepted uncritically.

Income-contingent or mortgage-style student loans?

An enormous literature has developed around the idea of income-contingent student loans and it is beyond the scope of this report to review that entire literature. We will be satisfied to establish a few of the key elements of the justification for such loans and to note some of the primary criticisms of them.

Most Anglo-American financial aid systems rely on the idea that government student aid should be based on recipients' "ability-to-pay". Those who have the resources to pay for tuition fees should do so and those who do not should have access to government grants, loans or both. The question, however, is whether "ability-to-pay" should be assessed *before* the student has finished post-secondary education or *after* that education has ended. Typically in Canada and the United States, "ability-to-pay" has been determined on the basis of the family income of student prior to their enrolment. In the Canada Student Loans Program (CSLP), the size of government-subsidized loans depends partly on the students' family income. In contrast, an income-contingent loan system offers loans to almost all students and bases the size of repayments required of them on post-schooling income. Post-secondary education has little out-of-pocket cost at the point of enrolment so family income is less relevant to enrolment decisions. Former students with high post-schooling income make regular payments while those whose post-schooling earnings is low receive government assistance. In effect, income-contingent loans provide insurance against the possibility of low post-schooling income.

Income-contingent loans can be administratively simpler than mortgage-style loans, especially in a country like Canada with its well-developed tax collection system. Income-contingent loans, collected through the tax system, avoid the need for a separate collection system of the sort represented by the two National Student Loans Service Centres (which are in charge of the collection of government-subsidized student loans in Canada). Moreover, because former students with low income are exempt from repayment, there is not much need for programs to help former students having difficulty with repayment. Canada's Interest Relief and Debt Reduction in Repayment programs would be unnecessary.

[8] Curtin (undated), p. 3.

Mortgage-style loans have fixed payments for a fixed period of time (roughly 9.5 years for CSLP loans). However, there is no link between required payments and the future income of the borrowers so that the proportion of that income that must be devoted to loan repayment can be quite high, creating significant burdens for some borrowers. By contrast, the amount that must be repaid on an income-contingent loan is a function of earnings and what is uncertain is the length of time over which repayments must be made. This feature is both a strength and a weakness of income-contingent loans. For those with low income, and who therefore do not make payments in some years, repayment can go on for a long time. The potential length of the repayment period is the source of much criticism. One response is that a lengthy repayment period is in line with the standard idea that the length of the repayment period for a loan should match the life of the asset being financed. Since student loans finance a lifetime of higher earnings, a long repayment period is not inappropriate. Another is that, as we will detail below, the average repayment period observed in practice is not much longer than the ten years typical of mortgage-style systems.

A potential problem with income-contingent loans is that of adverse selection. If students with bright economic prospects choose not to participate in the income-contingent loan program, then only those with less bright prospects will take up the loans. This adverse selection will lead to larger proportions of borrowers who are unable to pay back their loans, making the system more expensive to operate.

III. Tuition-Setting Practices in Australia, New Zealand and the United Kingdom, 1985-2005

If a pure market system requires that potential students face the true cost of their education, then we can say that, while the three countries under discussion here have moved in that direction, they have chosen to move only part way. Moreover, in two of the countries — New Zealand and the United Kingdom — there are no plans to move any further. By contrast, recent Australian reforms have moved in a significant way toward market prices.

Australia

As was true in many OECD countries, the Australian post-secondary sector grew in several discrete phases.[9] In 1949, a mere 30,000 students were enrolled in Australian universities (compared to more than 800,000 in 2003); each state capital had a university, the largest of which was the University of Sydney with 4,500 students. As a reminder that the link between post-secondary education and the labour market is far from a new idea, it was increasing demands for university-educated workers that led to the creation of a dozen new universities in the 1960s. Similarly, one of the goals was "the expansion, improvement and establishment of the appropriate institutions to provide a wide diversity of tertiary education."[10] Funding for these new universities was provided by the Commonwealth (i.e., federal) government; prior to this point, the state governments had the primary responsibility for higher education funding.

At the same time, the system of colleges of advanced education – essentially trade and vocational schools – was developed and expanded. Faculty in the colleges were to focus on teaching not research, and would offer diploma level courses rather than degree courses, much as Canadian colleges do. The emphasis was on technical subjects rather than on more general arts and sciences. This sector was important in Australia (as it is in Canada) with more than half of all post-secondary students in colleges rather than in universities. By 1974, there were 76 colleges offering a wide diversity of courses and degrees as well as 18 universities. Eventually, however, the distinction between colleges and universities blurred when the so-called binary system (i.e., distinct college and university sectors) was replaced by the Unified National system which involved many colleges merging and becoming universities.

By the late 1960s enrolments in higher education institutions had passed 200,000. Tuition fees had been a substantial (though hardly dominant) source of revenue for Australian universities. However, in 1974, the Whitlam Labor government abolished fees, hoping to encourage lower-income students to enrol in post-secondary education. The Commonwealth government also took full responsibility for the funding of the sector at

[9] The historical account of the growth of Australian post-secondary education here is based on Abbott and Doucouliagos (2003).
[10] Quoted in Abbott and Doucouliagos (2003) p.9.

that time. From that point until the late 1980s, there was "little political support for change."[11]

The late 1980s saw the convergence of a unique pair of educational policy goals under the Hawke Labor Government. The first was a desire to further increase post-secondary enrolments, a desire that was common across OECD countries at that time. However, this desire was paired with the desire of a social democratic government to fund the expansion by increasing tuition fees. The government believed — and argued publicly — that those who benefited from free post-secondary education were primarily from the upper half of the income distribution. If so, increased funding from general taxation would be regressive — cab drivers would be paying taxes to educate the children of lawyers.

In 1986, the first step toward a return to tuition fees was made with the introduction of the Higher Education Administration Charge (HEAC). While the HEAC was only A$250, it represented the first universal higher education charge since the abolition of tuition fees in 1974.[12]

The major step toward using private resources to fund higher education was made in 1989 with the design and implementation of the Higher Education Contribution Scheme (HECS) which incorporated the first large-scale income-contingent loan system in the world. Income-contingency was thought to be a means of "minimizing potential adverse impacts [of tuition fees] on participation." The level of contributions continued to be controlled by the government.

The Higher Education Contribution Scheme

As of January 1, 1989, university students were required to pay tuition fees of A$1,800, called the "higher education contribution".[13] By design, the A$1,800 contribution represented approximately 25 percent of the estimated annual cost of a higher education place. The explicit justification for the introduction of HECS was that students receive significant private benefits from higher education and should therefore bear part of the cost. As Chapman writes:[14]

> HECS came about because the government wanted to increase higher education enrolments but was not prepared to pay for the increased expenditure through taxation. Most importantly, 'free education' was seen to be regressive and unfair.

[11] Chapman (2004) p. 62.

[12] Prior to 1974, tuition fees were universal but the majority of students had some form of scholarship and did not pay full fees.

[13] Although the Wran commission, which had developed and recommended HECS, had suggested three levels of contributions, with higher contributions for higher cost fields of study, the government decided to impose a single $1,800 contribution.

[14] Chapman (2004) p. 63.

Table 1 shows the changing level of the HECS contribution from its inception up to the most recent changes. The level of the contribution was intended to vary according to an index of Higher Education Operating Grants. The contribution was accordingly adjusted in 1990 and 1991 but, in 1992, it was increased by more than the index required, illustrating an important point that is common across the experience of the countries in this report — the promises of one government cannot be assumed to be carried out by its successors.

A 1996 change in government from Labor to the on-going coalition of the conservative Liberal and National parties led to further changes. Beginning in 1997, all HECS contributions were increased by 40 percent and three "bands" of contributions replaced the single contribution. As a result, student fees now represented about 40 percent of the course cost. Each band contained a set of fields of study that were either deemed to vary in their costs, their economic returns or in their national priority. Not surprisingly, the highest contributions applied to professional degrees, including Law and Medicine and the lowest to fields including the Arts and Humanities.

Another important 1997 change, and one that figures prominently in the most recent reforms, was the introduction "full fee-paying" places in the universities. The federal government had previously set the number of places available in any university program by specifying the number that were HECS-eligible. As of 1997, universities could admit up to 25 percent more students in any program and charge them whatever fees they deemed appropriate. These additional students were not eligible for HECS and had to pay their fees up-front.

The period from 1997 until 2004 was one of relative stability as the three bands of contribution levels increased by the indexed amount. However, the changes legislated by the Coalition government in 2003 and which came into effect on January 1, 2005 are quite significant. While it is too early to know what the ultimate effects will be, Bruce Chapman, the leading analyst of such matters in Australia and the architect of HECS, believes that "the transformation of Australian higher education funding after 2005 is likely to be more profound than was the case with all other funding changes over the last 30 years or so." [15]

Before describing the most recent reforms, a digression is necessary. While Table 1 shows the nominal level of the HECS contribution, students' true financial expenditure on HECS (the "effective price" or the "true cost of tuition") will depend not only on the nominal level but also on the method by which the contribution is paid. As will be discussed in detail in the next section, students have the option of paying the contributions on an income-contingent basis after leaving school. The effective price will therefore vary according to the future income of the borrowers. For example, if former students never earn more than the first threshold, the effective price will be zero. This is important because a reform that raises HECS contributions but makes the repayment

[15] Chapman (2004) p. 61.

terms more generous — as does the 2003 reform — will have uncertain effects on the ultimate contribution made by students.

The two major changes created by the 2003 legislation involve the transformation of HECS into HECS-HELP and the creation of a new FEE-HELP plan. One effect of both new plans is that universities will be able to increase the level of tuition fees (up to a ceiling in the case of HECS-HELP). That ability is important — the revenues of the sector had fallen consistently over the 1995-2005 period because of the way that government grants (which made up more than half of all revenues, even after the 1996 reforms) were calculated.

In the case of HECS-HELP, the government sets a "standard" HECS rate and the universities can set their own HECS contribution levels that are up to 25 percent higher than the standard. As Chapman notes, the public discussion of the changes focused on the higher charges and the effect that they might have on the access of lower-income students.[16] However, a second change, raising the first repayment threshold from about A$26,000 to about A$36,000 lowers the true cost for many former students. In simulations undertaken by Chapman, he finds that for former students earning at typical levels or higher, HECS-HELP will result in a higher true cost of tuition. For those earning less than typical levels, however, HECS-HELP is cheaper than HECS.

Prior to the introduction of FEE-HELP, full-fee paying students had to pay their substantial fees up-front since they did not have access to the HECS repayment plan. As a result, perhaps, only a limited number of students (about 6,000 per year or 2 percent of post-secondary students) took up full-fee paying places, even though universities were allowed to enroll significantly more such students. FEE-HELP extends the income-contingent repayment loan program to full-fee paying students. In addition, the universities are allowed to admit up to an additional 35 percent of their course enrolments as full-fee paying students (rather than 25 percent before the reforms). A final change is that a loan maximum of $50,000 will be imposed on FEE-HELP students.

The possible implications of these changes will be discussed in the concluding part of this section.

New Zealand

New Zealand, with a population of roughly 4 million people, is quite a bit smaller than Australia, with its 20 million people. The New Zealand system of post-secondary education is correspondingly smaller, consisting of eight universities and 23 polytechnic institutes. Unlike Australia, in which states wield considerable power, most political power in New Zealand rests with the federal government.

At roughly the same time as Australia was introducing tuition fees and income-contingent loans, New Zealand was doing the same. Even though vastly different political parties were in power — the social democratic Labor party in Australia and the free-market

[16] Chapman (2004) p. 65.

National party in New Zealand —the underlying concerns were similar. Like Australia, New Zealand saw a need for a rapid expansion of higher education to serve the contemporary labour market but was not prepared to finance that expansion solely from tax revenues. In the years prior to the new regime, New Zealand students paid only nominal fees. In 1990, a common fee of NZ$1,250 was mandated but almost immediately thereafter, in 1992, the common fee was abolished in favour of allowing institutions to set their own fees. That is, unlike Australia, where fees were common across institutions and determined by a central government agency, New Zealand allowed institutions to set their own fees almost from the beginning.

A period of rapid fee increases followed (accompanied by, and perhaps driven by, reduced government subsidies to the institutions). Fees increased at a rate of 14 percent per annum in the 1995-1999 period.

A 1999 change in government to the less conservative Labour party led to a change in the fee-setting policy. In exchange for a freeze on fees, the government offered the universities greater per student subsidies. As a result, no tuition increases occurred in 2001, 2002 or 2003. Beginning in 2004, the government established "fee maxima" which allowed the post-secondary institutions to raise fees up to maxima set by discipline and level of study. A cap of 5 per cent was set on the greatest possible increase in fees at the undergraduate level. In the end, most universities raised their fees close to the new fee maxima.

Since the beginning of the 1990s, then, tuition fees have come to vary across both fields of study and across institutions. However, the variation across fields of study is greater than the variation across institutions. This can be seen for three selected undergraduate fields of study in the "fee maxima" column of the next table (Maani, 2002). The range of fees, reflecting differences across the eight universities, is relatively small. The bigger differences are between fields. The per student subsidy levels are common across universities and, as can be seen in the first column, vary significantly by field of study.

	Undergraduate EFTS Subsidy Level	Fee Maxima
Arts	$5,881	$2,950-$3,880
Science	$9,111	$3,740-$3,840
Medicine	$20,476	$9,180-$9,646

The United Kingdom

The United Kingdom is far larger than either Australia and New Zealand and has more than 100 universities. Before the 1990s, the UK system of higher education followed the "Scandinavian" model with relatively low enrolments, no tuition fees and (means-tested) living allowances. In the late 1980s, the participation rate was about 14 per cent. Over the ensuing years, participation grew considerably, rising to about one-third by 2000. However, this expansion was not accompanied by increased university revenues.

After years of declining funding, increasing enrolments and growing concern about the resultant quality of post-secondary education, tuition fees and income-contingent loans were introduced in the wake of the 1997 Dearing Report. For students starting university in October, 1998, a flat £1000 tuition fee was introduced, regardless of institution or field of study; the tuition fees had to be paid up-front but students could borrow, on an income-contingent basis, to pay them. As Table 1 shows, the maximum fee has risen by a relatively small amount in each of the ensuing years.

Not all students paid the full amount of the tuition fee. For example, in 2003-2004, students whose parents earned less than roughly £21,000 were exempt from the fee, those whose parents earned more than £31,000 paid the full amount and those with parental income in between those two values paid partial fees. The thresholds divided the student population into three roughly equal parts so that one-third paid no fees, one-third paid full fees and one-third paid partial fees.

While the introduction of tuition fees was a movement away from the Scandinavian model, not much had really changed. The system of centralized determination of student numbers and tuition fees was maintained; that is, a government agency determined the level of fees and the number of students that each university could recruit. Institutions that did not conform to the central plans were penalized financially.

In 2004, the UK parliament narrowly passed a series of important reforms to higher education finance, despite energetic opposition from within the ruling Labour Party. Beginning in the 2006-2007 academic year, fees that can vary by course and by institution will take effect. Students need not pay the fees up-front and can instead repay them after graduation on an income-contingent basis. One of the goals of the reform package is to achieve a 50 percent university participation rate by 2010.

The reforms allow universities to set any tuition fee between £0 and £3000. In principle, this allows universities to charge lower fees for lower cost programs and higher fees for higher cost programs. In practice, however, what has happened is that virtually all universities have chosen to raise tuition fees to £3000 for all courses of study. Because the £3000 fee will not be paid up-front by the students, the government will pay the tuition fees up-front to the universities (and then collect from former students on an income-contingent basis).

As in the Australian case, the public discussion has focused on the increase in fees from £1,150 in 2005-2006 to £3,000 in 2006-2007. In fact, however, the package of changes will likely leave low-income students with lower effective fees. One key difference is that the £1,150 must be paid up-front while the £3,000 will be paid by an income-contingent loan bearing no real interest. A second difference is that the new system restores the maintenance grants that had been phased out in 1998. One estimate is that 50 percent of students will receive some sort of grant.[17] Low-income students receiving the full amount of the new grants will pay no tuition fees. Students can borrow to cover living expenses and repay using the income-contingent program.

[17] Mike Baker, BBC, 5 August 2005. available at http://news.bbc.co.uk/1/hi/education/4749575.stm.

Discussion

The theory presented in Section II argues for variable fees that can reflect the diversity of post-secondary institutions, a diversity not only in their costs of providing education but in student demand for places in their courses.

The empirical description in this section shows that Australia, New Zealand and the United Kingdom now have systems that allow institutions to have some control over the fees that they charge, subject to government-established maximum fees. In that sense, the ground has been prepared for the empirical implementation of the theoretical model set out in Section II.

That said, none of the countries has yet seen fees that *actually* vary in the way envisioned by the theory. Beginning in 1996, three levels of Australian fees were established but the fees remained common across all universities. In the UK, fees have been common across universities and courses since their introduction in 1997. As the result of the most recent reforms, fees rose almost uniformly to £3,000 even though each university was allowed to choose any fee between £0 and £3,000 for any of its courses. In New Zealand, where universities were given the ability to set their own fees in 1992, the fee structure that developed has come to differ by fields of study more than it differs by institution. Moreover, when a new government came to power in New Zealand, it constrained the ability of the universities to raise fees by first negotiating a tuition freeze and then imposing fairly restrictive maximum fee increases. Only the current Australian reform, which allows universities to increase current fees by 25 percent and allows them to try to create a large category of students who pay full fees, holds the prospect of a sharp movement in the direction of a full-blown market system.

Thus, while part of the story here is about a successful, albeit slow, evolution toward a full-blown market system, another part of the story is about a successful effort to forestall that evolution. For better or worse, several aspects of the theoretical model seem unable to garner the public or political support needed. These aspects are mentioned here and discussed more completely in later sections.

First, charging market rates of interest on income-contingent loans seems difficult, if not impossible. While economists are comfortable with the idea of incorporating the time cost of money into decision-making, the general public seems to object to student loan debts that grow larger, as they inevitably would for some borrowers in an income-contingent program charging any real interest. All three systems now have substantial interest subsidies (though Bruce Chapman argues that HECS actually has an implicit real interest rate created by the possibility of paying up-front and receiving a discount for doing so).[18]

[18] See the next section for a discussion of the implicit interest rate created by the up-front discount available in the Australian system.

Second, the prospect of significantly higher fees, even when accompanied by income-contingent loans, sets off alarms in the minds of the many people who are concerned about participation rates of students from lower-income families. Neither the theoretical argument about the positive role that income-contingent loans can play in improving access, nor the empirical evidence that low-income access has not declined, nor any modest enhancements in means-tested student aid seem to allay those fears.

IV. Empirical Experience with Income-Contingent Repayment Loans in Australia, New Zealand and the United Kingdom

The capital market imperfections mentioned in Section II have led many economists to recommend government intervention to allow lower-income students to borrow in order to finance their post-secondary educations. Income-contingent student loans are thought to be superior to mortgage-style loans because they provide insurance against low post-schooling income, make post-secondary education free at the point of use and involve lower administrative costs. This Section describes the income-contingent systems that have existed in Australia and New Zealand for more than a decade and the income-contingent system that came into existence in England in the 2006-2007 school year. Table 2 summarizes the three systems.

Australia

HECS was the first broad-scale income-contingent repayment loan system in the world. When the A$1,800 HECS contribution was instituted in 1989, students were not required to pay the contribution at the time they enrolled. Instead, they could choose – as the vast majority did – to defer the payment of the contribution until after they had left school. In that sense, the required contribution was a government loan since the government paid the institutions in lieu of the students' now-deferred fee. For a social democratic government worried about access for low-income students, the income-contingent nature of HECS was especially appealing. No fees would be payable at the time of enrolment, making a university education "free at the point of use" and thus reducing one of the barriers thought to impede low-income enrolment.

Moreover, the amount of each year's repayment depended on the taxable income of the former students. If the former student had taxable income less than a threshold amount, no payment was required. Above the threshold, a fixed percentage of taxable income was paid to the government through the Australian Tax Office. No interest was charged on the deferred contribution but the amount outstanding was indexed to the rate of inflation so that its nominal value increased each year. If they so chose, student could have paid for the 1989 contribution "up front", without deferring it, and receive a 15 percent discount for doing so.[19]

At the beginning of HECS, in the 1989 academic year, the income threshold below which no payments were due was set at A$22,000, a threshold linked to aggregate average earnings in Australia. For those with income above A$22,000, there were three repayment rates which rose along with income. Between A$22,000 and A$25,000, the rate was 1 percent and rose to 2 percent for those earning between A$25,000 and A$35,000. Those whose incomes were above A$35,000 paid 3 percent of that income toward the deferred contribution.

[19] The terms of HECS loans were, and are, far more generous than any commercially available loan, mitigating the adverse selection problem mentioned on p. 9.

HECS was far from a static system. As noted in the last section and shown in Table 1, the amount of the contribution was adjusted upward each year and this was true of the repayment thresholds as well. In 1991, the three repayment rates were adjusted upward to 2, 3 and 4 percent. In 1993, the discount for up-front payment was increased to 25 percent in order to increase the number of students paying their contribution up-front. In 1994, the repayment rates were raised yet again to 3, 4 and 5 percent. For 1996-1997, the repayment system grew more complicated. Seven repayment rates were introduced, rising from 3 percent for those with taxable income between A$28,500 and A$30,000 to 6 percent for those with income above A$51,000.

When the Coalition government came to power in 1996, they not only introduced HECS contributions that varied by field of study but they substantially reduced the first repayment threshold, below which no payment was expected, from the 1996-1997 level of A$28,495 to a 1997-1998 level of A$20,701. That change clearly reduced the generosity of the repayment regime and reduced its implicit subsidy.

One of the least appealing features of HECS, as it has operated in Australia over the past 15 or so years, has been the frequency with which it has undergone significant change.[20] Because the parameters changed so often and by so much, students could have little certainty that the rules of the system under which they borrowed would be in force when they began repayment. For example, students who borrowed thinking that they would face no repayment if they had less than median taxable earnings were suddenly faced, in 1997, with the necessity of making payments even if their income was significantly below that median. Chapman and Salvage (1997) estimate that the 1997 reforms increased overall repayment obligations by about 10 percent.

Some particular features of HECS reoccur in the context of other countries' efforts to institute income-contingent repayment systems. These features will be introduced here and then taken up again when the New Zealand and United Kingdom systems are discussed.

Eligibility for the loan program: When HECS began in 1989, all university students were eligible to defer their contributions and repay them through the tax system after they left school. Students from wealthy and poor families alike were eligible for HECS and all received the subsidies implicit in the relatively generous HECS repayment terms. Over time, this universality has eroded at the edges but, by and large, has been maintained.

Discount for up-front payment of the contribution: Students who are able and willing to pay the HECS contribution "up-front" receive a substantial discount. When HECS began, those who paid up-front received a 15 per cent discount although the discount has varied somewhat over the years.. Moreover, any advance payments of the accumulated HECS liability are now discounted (e.g., paying $500 above the amount due yields more than a $500 reduction in the amount outstanding).

[20] Personal interview with Bruce Chapman, January, 2005.

Interest Rates: No real interest accrues on HECS contributions. Instead, they are simply indexed to the rate of inflation. This lack of a real interest rate is more apparent than real however. As Chapman has pointed out, there is a substantial implicit interest rate because of the option, just described, to pay the contribution up-front, with a substantial discount.[21]

> …HECS already has a rate of interest greater than the rate of inflation. That is, those choosing to repay HECS through the tax system rather than up-front, pay 33.33 per cent higher in nominal terms, given that there is a 25 per cent discount.

The lack of market interest charges substantially raises the cost of the program to the government so this feature of HECS has generated some controversy. Interest is charged on many other student loans, including the mortgage-style Canadian and American loans.

Barr strongly recommends that income-contingent student loans bear real interest rates: "..the case against interest subsidies is thus damning: they are inefficient, expensive and unfair".[22] Usually heard in the context of mortgage-style loans, the efficiency argument is that even students who do not need to borrow will borrow at the subsidized interest rate, invest the money in government bonds, accumulate interest while in school and then repay the loan from the proceeds of the bond immediately upon graduation. While this is theoretically possible, it seems empirically unlikely and no widespread evidence of the phenomenon has been published. The cost and equity arguments are, respectively, that the interest subsidies are quite expensive to the government and that the subsidies go disproportionately to the middle class (if the regressivity argument discussed above is true) because higher education students are disproportionately middle-class. Without interest subsidies, however, the politically explosive issue of negative amortization arises; that is, the amount owed will rise, potentially by large amounts, for those who make no payments or only small payments.

The repayment period: As noted in the theoretical section, mortgage-style loans have fixed monthly payments and a fixed repayment period. With income-contingent loans, the repayment period can vary significantly. To economists, a potentially long repayment period seems appropriate (because the life of the investment in human capital roughly matches the length of the repayment period) and quite generous to borrowers since the interest subsidy provided by the government grows with each year. However, to the borrowers (and especially to student groups), the potentially long repayment period sounds like a "life sentence" to debt repayment. In practice, however, the average repayment period for income-contingent loans is approximately the same 10 years that specified by a standard mortgage-style student loan.

Income threshold: As the above description illustrates, there is no certainty that the level of the income threshold above which payments must be made will remain constant over time. The original HECS threshold was linked to median earnings. However, the in-coming Coalition government lowered the threshold to near the poverty line for 1997.

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[21] Chapman (2002) p. 12.
[22] Barr (2001) p. 189.

The 2005 reforms increased the first threshold significantly, back to a level closer to median earnings. Clearly, the generosity of an income-contingent program depends on the income threshold (and on the repayment rates demanded).

Repayment rates: Similarly, repayment rates can vary over time. The original repayment rates were purposely set quite low to reduce potential opposition to the introduction of HECS.[23] The lower the rates, the greater the cost of the system because of the continuing interest subsidy and the potentially long repayment period. As a result, there was pressure from the beginning to raise the required repayment rates. Apart from cost considerations, there is little theory underlying the choice of repayment rates.

Collection through the income tax system: The Australian Tax Office was charged with collecting the deferred contributions. Prior to their introduction, the ATO argued against the creation of HECS, arguing that collecting the repayments would dilute its primary mission of collecting taxes. However, one of the major appeals of income-contingent loans is precisely the use of well-developed tax agencies to make collections. Eventually, the ATO came around to support HECS. HECS is apparently cheap to administer, realizing the theoretical hope that such a collection mechanism would obviate the need for the separate loan collection scheme required by mortgage-style loan systems.

The maximum amount that can be borrowed: The maximum amount that can be borrowed through HECS is the amount of the contribution. That is, borrowing is limited to that necessary to pay tuition fees; borrowing for living costs, or for books and supplies, is not allowed. As the level of contributions rises, concern about the cost of the implicit subsidy also rises. For that reason, apparently, a maximum of A$50,000 is in place for the income-contingent borrowing of full-fee paying students under FEE-HELP.

New Zealand

Even though the spirit of the Australian and New Zealand income-contingent repayment loan programs was similar, the terms of the New Zealand scheme were different than those of HECS. An important difference, apart from differences in the actual features of the programs, is that the New Zealand parameters remained constant from 1992 to 1999, changing only with the 1999 change in government.

To see the differences in the New Zealand income-contingent loan system, each of the important features is discussed in turn.

Eligibility for the loan program: As in Australia, all students are eligible to borrow from the income-contingent loan program.

Discount for up-front payment of the contribution: No discount for up-front payment of the fees is offered.

[23] Personal interview with Bruce Chapman, January, 2005.

Interest rates: Until 1999, income-contingent student loans in New Zealand bore market interest rates that were in force from the time when the borrowing occurred. However, after the Labour party was elected in November, 1999, interest subsidies were introduced for the first time. From 1999, no interest accrues on the amount borrowed while the student is studying full-time. In this respect, the New Zealand system is now like Canadian and American government student loan programs.

After the student leaves school, an interest rate of 7 percent is applied to the outstanding loan balance. However, again beginning in 1999, borrowers could qualify for interest subsidies while in repayment. Each year, the 7 percent interest rate is divided into two components. One component is the rate of inflation and the other, called the "base interest component", is the real interest rate, the difference between the 7 percent nominal interest rate and the inflation rate. Former students whose income is less than the repayment threshold qualify for a full base interest subsidy. That is, they make no payments on their loan and the amount of the loan increases only by the rate of inflation. Former students whose income is above the threshold are eligible for a reduction in the amount of base interest that they pay if the base interest constitutes more than 50 percent of that year's assessment. The amount of the subsidy for such borrowers is the amount by which the base interest exceeds 50 percent of the assessment.

The effect of these interest subsidies is to ensure that borrowers with income below the threshold pay no real interest (as in Australia) and that at least 50 percent of the payment for all other borrowers will be used to reduce the loan principal.

The ruling Labour Party announced that it would make student loans entirely interest-free if it was re-elected in September, 2005. The opposition National party proposed a tax credit for interest payments on student loans.[24] In the election, no party won an outright majority. The Labour Party eventually formed a coalition with several smaller parties that enabled it to remain in power. As of April 1, 2006, student loans will become interest-free, as promised during the election campaign.[25]

The repayment period: In New Zealand, there is no maximum repayment period for student loans. Short of dying or filing for bankruptcy, therefore, the unpaid balance will remain with the borrower indefinitely. The median time to full repayment, however, is approximately seven years (Hyatt, 2005).

Income threshold: The New Zealand repayment threshold is quite a bit lower than the Australian threshold. The New Zealand threshold has always been linked to the welfare benefit received by a lone parent with two or more children.[26] Over time, the New Zealand threshold has been set in more or less the same way while Australia's has varied considerably.

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[24] http://www.nzherald.co.nz/index.cfm?c_id=1&ObjectID=10337679

[25] See http://www.scoop.co.nz/stories/PA0507/S00553.htm.

[26] The threshold is "aligned with the domestic purposes benefit paid to people with two or more children." (http://www.beehive.govt.nz/ViewNewsletter.aspx?DocumentID=15904. The domestic purposes benefit is the welfare benefit for single parents in New Zealand.

Repayment rates: It is difficult to compare the relative generosity of the student loan repayment rates in New Zealand and Australia. The repayment rate for the New Zealand system has remained constant at 10 percent of difference between before-tax income and the repayment threshold. By contrast, HECS repayment rates, while set at considerably lower levels, apply to all income, as long as income is above the threshold. The HECS repayment rates were set at very low levels in 1989 and, while the rates have risen over time, they have approached 10 percent only in the last round of reforms and only then for the highest earners.

Collection through the income tax system: As in Australia, collections on student loans are made through the department in charge of tax collection in New Zealand (called Inland Revenue).

The maximum amount that can be borrowed: Income–contingent repayment is available in Australia only for HECS contributions. By contrast, New Zealand students can borrow not only for the full amount of tuition fees but also up to NZ$1000 for course-related costs and up to NZ$150 for living expenses in each week of full-time study. Since the loans bore market interest rates prior to 1999, however, there was little incentive to borrow unnecessarily.

Treatment of loans in bankruptcy: In Australia — as in all other countries with student loan systems — HECS contributions were not and are not dischargeable in the event of bankruptcy. In New Zealand, student loans are dischargeable.

The United Kingdom

As noted in Section III, UK students will have the option to pay the new £3,000 tuition fee on an income-contingent basis. The government agency in charge of student loans will pay the fee on behalf of the borrowing student and then collect on the loan through the tax system after the student leaves school.

Income-contingent student loans were introduced in the UK as a result of the 1998 reforms that first introduced up-front tuition fees. Under that plan, which is still in existence, student support consists of (a) the tuition subsidy described in Section III and (b) an income-contingent loan to cover living expenses. In the context of the income-contingent loan to cover living expenses, students from families with different levels of income are treated differently in the system in existence from 1997-2005. For example, a low-income student receives a £4,000 income-contingent loan to cover (partially) their living expenses during the year.[27] Students from high-income families can borrow three-quarters of the maximum amount (£3,000) from the income-contingent loan program. Students whose parental income is between the low- and high-income threshold qualified for intermediate amounts.

While the new system of income-contingent loans has not yet come into force, its parameters are clear.

[27] http://econ.lse.ac.uk/staff/nb/Barr_Selcom020424.pdf

Eligibility for the loan program: All students are eligible to borrow from the income-contingent loan program.

Discount for up-front payment of the contribution: No discount for up-front payment of the fees will be offered.

Interest rates: As in Australia, no real interest will be charged on loan balances. Balances will be adjusted to reflect the rate of inflation. The absence of an up-front discount means that even the indirect form of interest created by that option will be absent.

The repayment period: Loans that are not repaid in the 25 years following the date on which the former student left school will be forgiven.[28]

Repayment rates: The repayment rate will be 9 percent of income above the £15,000 threshold.

Income threshold: The repayment threshold has been set at a gross income of £15,000 (an increase from the £10,000 threshold in the 1997-2005 system). Note that this threshold is quite a bit higher than the New Zealand threshold even though the repayment rates are similar, implying that the English system will be more generous to borrowers.

Collection through the income tax system: As in Australia and New Zealand, loans are repaid through the UK tax system.

The maximum amount that can be borrowed: There will be two forms of borrowing in the new system. First, a Student Loan for Fees will be available, with repayment made on an income-contingent basis, to pay tuition fees. Second, students will be able to borrow to pay living expenses. Lower-income students will be able to borrow to pay for their living expenses and to pay back the loans through the income-contingent loan system. Higher–income students will be able to borrow 75 percent of maximum amount that lower-income students can borrow. In addition, lower-income students will benefit from the creation of a new set of maintenance grants of up to £2,700 per year.

[28] See http://www.aimhigher.ac.uk/student_finance/2006_onwards/help_with_fees__2006_07_.cfm

V. Studies of the Effects of the Introduction of Tuition Fees and Income-Contingent Loans of Post-Secondary Access

This section of the report takes up the question of whether the introduction of tuition fees and income-contingent loans in Australia, New Zealand and the UK affected the post-secondary access of lower-income students. A starting point, however, is the observation that there are persistent and large differences between the post-secondary participation of young people from rich and poor families in every industrialized country.[29] These differences exist in systems with no tuition fees and generous living allowances; they exist in systems with high tuition and no living allowances. Reducing these disparities is a continuing goal in all OECD countries but it seems unlikely that one change in post-secondary funding (such as the introduction of HECS-like systems) could by itself change this situation.

In all three countries, the introduction of tuition fees and income-contingent loans sparked intense debate about the possible negative impacts on lower-income students. Two distinct positions on the issue are evident and both positions are supported by some empirical evidence. No resolution of the debate, however, is in sight, because the funding changes were introduced as a package with many other changes. For example, HECS was introduced at the same time as the government announced a concerted effort to raise the percentage of students completing Grade 12. Isolating the effect of one change amidst the others has proven to be daunting challenge.

The first position holds that lower–income students are especially likely to be discouraged from post-secondary enrolment by the changes (Callender, 2003). Since the presence of income-contingent loans actually reduces the up-front costs of post-secondary education, this argument depends on low-income students being more averse to going into debt or more concerned about the risk involved in higher education. If so, the package of higher tuition plus income-contingent loans will differentially affect lower-income students.

The alternative position is that the average financial rewards to post-secondary education are so large, relative to the tuition levels observed thus far, that any large effect on potential students' decisions is unlikely. It is often additionally argued that the cause of the differential post-secondary access of low-income students lies further back in time, with significant differences in achievement levels appearing in elementary school and persisting through secondary school.

Reviewing the literature on educational inequality and the role of family income in perpetuating that inequality is well beyond the scope of this report. Instead, we review the limited evidence on the effects of HECS in Australia and on the effects of up-front tuition fees in the UK.[30]

[29] OECD (1998) p.32.
[30] Canadian evidence on this issue is summarized briefly in the conclusion.

Does HECS Deter?

One Australian line of research concerning the possible deterrent effects of HECS builds on the second argument mentioned above by calculating the effect of HECS on the rate of return to post-secondary education (Borland, 2001 and Chapman and Salvage, 1997). These studies find that HECS reduced the average rates of return (as one would expect, given the increase in cost) but that the reduction was small enough so that any great impact on participation was unlikely.

Another line of research, sponsored by the government department responsible for post-secondary education and training, looks at actual enrolment data at various points in time and tries to assess whether the proportions of commencing post-secondary students from various socio-economic groups were lower after the introduction of HECS (or after the significant changes in 1996-1997).

We review two studies of the effect of HECS on post-secondary access in Australia and one on the more general issue of how Australian post-secondary participation varies by socio-economic status. The first HECS study uses a variety of methods to assess its impact and concludes that "these differing approaches point to HECS being a very minor influence, if a factor at all, for the low participation of low SES groups."[31] The second study (Aungles et al., 2002) uses similar techniques to the first in studying the effects of HECS on the access of the poor but examines a longer time period. However, Curtin (undated) argues based on a paper by Long et al. (1999), that these two government-sponsored studies may understate the effect of HECS on low-income enrolments. The results of Long et al. (1999) are reviewed below.

Simply defining "lower-income student" for the purposes of studying the determinants of post-secondary access is often problematic. Few individual-level data sets collect family income, parental education and parental occupation, variables that are the typical components of an overall measure of socio-economic status. One option is to use the postal code of students' residence as a proxy for socio-economic status. The average characteristics of the geographic areas defined by postal codes can be calculated from Census data and the students' postal code is collected as part of the application process.[32] The survey responses of students (such as those used by Long et al.) concerning parental income, education and occupation are not likely to be highly reliable.

The evidence from Australia based on postal codes and summarized by Andrews is that the proportion of students from low-SES areas has been consistently lower the proportion from higher-SES areas. Past studies suggested that low-SES students participated at about

[31] See Andrews (1999) p. vii.

[32] Using students' postal codes to infer their socio-economic status is clearly imperfect. A high SES student may be living in an area with low average SES. And a low-SES student may be living in an area with high average SES. The more diverse are geographic areas, the more likely it is that any individual student will be misclassified. However, the available alternatives to using postal codes to define SES are sometimes quite limited.

60 percent of their proportionate share and that "there has been little improvement in the social composition of students over the past several decades".[33]

The disproportionately low post-secondary participation of low SES groups generated a number of the policy initiatives in Australia, some of which were reviewed above. These included the abolition of university fees in the 1970s and the introduction of HECS in 1989. Moreover, programs such as AUSTUDY (and its successor Youth Allowances) were introduced or augmented to help pay maintenance costs.

The first important result noted by Andrews is that the proportion of post-secondary students applying from low SES postal codes remained constant after the introduction of HECS, even as post-secondary participation rose fairly dramatically (by 23 percent) between 1989 and 1998. Describing the decade of the 1990s, he notes that "over the past decade the proportion of commencing 17-24 year old higher education students from postal areas containing the lowest SES quartile has ranged from 19.4 to 20.3 per cent with no discernible trend." Andrews could not, however, analyze the effect of the 1989 introduction of HECS on these proportions because no comparable pre-1989 data was available.[34]

The second important result reported by Andrews is that the introduction of higher fees in 1996 by the incoming Coalition government, accompanied by the introduction of three "bands" of fees, had little effect on the proportion of low-SES students in each band. Each band consisted of a number of fields of study. For example, medicine, law and dentistry were in the high tuition band. Even though fees for fields in the lowest band increased by roughly 30 per cent and fees in Band 2 and Band 3 increased by 90 and 120 per cent, respectively, the proportion of students from the lowest quartile postal areas did not change in any significant way in 1997 or 1998.

Andrews' study of the effects of the 1996 HECS changes was limited to the two years following the changes. Aungles et al (2002), using the same methods, extended Andrews' analysis out to 2001 and presented somewhat more disaggregated results. Overall, they report that "it is not apparent that the 1996 HECS changes have had an adverse impact on the share of commencing students from a low SES background." Aungles et al. were also able to look at various subgroups among the low-SES students. They distinguished between two age groups (under 19 and 20-24), between genders and among the three HECS bands. When the participation of these sub-groups of low-SES students is examined, the major result is that the proportion of male low-SES students in Band 3 courses of study (law, medicine, dentistry and veterinary science) fell by about 15 per cent between 1996 (the last year before the increases in fees) and 2001. The proportion of female low-SES students commencing in Band 3 was unaffected. The 15 per cent drop in male low-SES Band 3 enrolments translates into 200-300 students (Aungles et al., 2002).

[33] Andrews (1999), p. 4.
[34] Andrews (1999) notes, however, that data from other sources that are not exactly comparable also suggests no change from the pre-1989 period.

Data limitations prevented any analysis beyond the above comparisons and the drawbacks of such aggregate analysis are apparent. The actual income or SES of the students is not observed and the average income or SES in their postal code area must be used instead. More importantly, perhaps, other changes beyond the changes to HECS might have affected the participation rate of lower-income students.

Andrews (1999) and Aungles et al. (2002) examined the composition of "commencing students" and found, more or less, that the proportion of commencing students who came from low-SES postal codes was relatively constant during the 1990s. The implication is that the introduction of HECS and the 1996 changes did not affect access. However, another important and related change was on-going in Australia over the same time period. In 1980, only 35 per cent of Australian young people finished Grade 12 and were thus eligible to enroll in a post-secondary program. For a variety of reasons (including government programs and changes in the labour market) that proportion rose to 78 percent by 1994.[35]

Long et al. use longitudinal data from four separate cohorts of Australian young people to demonstrate that the constant percentage of commencing students from low-SES backgrounds observed by Andrews and by Aungles et al. was actually the result of two countervailing influences. First, the increase in Grade 12 completion was disproportionately weighted toward lower-SES students so that more lower-SES students were completing Grade 12 and thus becoming eligible for higher education. Second, the entry rates to universities by students from lower-SES backgrounds actually declined relative to the entry rates from higher-SES students.. The result was the constant percentage of *commencing* lower-SES students.

While overall proportion of young people graduating from Grade 12 rose from 35 percent to 78 percent, the increase was from 28 percent to 73 percent among students whose parent(s) were unskilled workers. Among the white collar occupational categories, the increase was smaller — from 61 percent to 90 percent among professional families and 45 to 79 among managerial families.

The proportion of the Grade 12 graduates from blue-collar backgrounds who enrolled in universities fell between the first and fourth cohorts, from percentages in the 40s for the cohort who were 19 years old in 1980 to percentages in the 30s for those who were 19 in 1994. For example, among students whose parent(s) were in unskilled occupations, the percentage of Grade 12 graduates entering university was 40 percent for the 1980 19-year olds; the entry rate fell to 33 percent for the 1994 19-year olds. For the semi-skilled category, the corresponding percentages were 47 and 26.[36]

The point here is that access to post-secondary education generally requires two steps — graduating from high school and then entering a post-secondary institution. Analyzing trends in access requires analyzing both pieces. Andrews (1999) and Aungles et al. (2002) analyzed only the second.

[35] Long et al. (1999) p. vi.
[36] Long et al. (1999) p.57.

However, Long et al. also demonstrate that the entry rates to any form of post-secondary education (i.e., not only universities but also vocational colleges and apprenticeships) did not change for the different SES groups. That is, a lower percentage of lower SES high school graduates went on to university but a higher proportion entered vocational colleges and apprenticeships.

The massive increase in Grade 12 completion and in post-secondary enrolments was the goal set by successive Australian governments. It is far from clear that the decline in the proportion of low-income Grade 12 graduates who went on to post-secondary education was the result of any changes in the post-secondary funding system. However, the general feeling that access has not been harmed, a feeling supported by the constant proportion of low-SES entering students should be leavened with a concern that a falling proportion of *eligible* low-SES students is enrolling.

Did the Introduction of Tuition Fees in the United Kingdom Impede Access?

In this section, we review some recent work on access in the UK. In the last round of changes described above — giving universities the freedom to set their own fees up to a maximum of £3,000 per year — concerns over equity almost caused a rebellion within the ranks of the ruling Labour Party and resulted in significant concessions designed to ensure that post-secondary access was not impaired by the changes. One important concession was the reintroduction of maintenance grants for lower-income students. Thus, as in most countries, changes to post-secondary funding that involve higher fees spark deep concerns over the access of low-income students.

Galindo-Rueda et al. (2004, hereafter G-R) paint a picture of post-secondary access in the UK that applies, to a greater or lesser degree, in the other countries:[37]

> Access to higher education in the UK has always been predominantly limited to those from higher socio-economic groups. Certainly if one looks at the very top and bottom of the socio-economic scale, the situation is dire. More than three quarters of students from professional backgrounds study for a degree, compared to just 14 percent of those from unskilled backgrounds. Moreover, this inequity has persisted over the last forty years.

Galindo-Rueda et al. set out to analyze whether the 1997 changes to the UK funding system — the introduction of fees of £1,000 per year and the replacement of maintenance grants with income-contingent maintenance loans — affected post-secondary access. They analyze individual-level survey data on two cohorts of young people, one cohort that was of university entry age prior to the changes and one similarly-aged cohort after the changes. Their two cohorts of young people were not widely separated in time. One cohort was 18 years old in 1996 and the other cohort was 18 years old in 2000. Those who were 18 in 1996 would not have had to pay tuition fees if they enrolled in university while those who enrolled in 2000 would have had to pay just over

[37] Galindo-Rueda et al. (2004) p. 77.

£1,000 per year. Despite the short period separating the two cohorts, Galindo-Rueda et al. find significant changes in the determinants of post-secondary participation (where "participation" is defined as being enrolled in a post-secondary institution when the person was surveyed). For example, in the 1996 cohort, 29 percent of those enrolled in university had professional parents; in the 2000 cohort, that percentage had risen to 38 percent.[38]

G-R show that the importance of socio-economic status declines if secondary school achievement is included as a covariate in a multivariate model. This fact simply points to one mechanism by which socio-economic status might make a difference. For whatever reason, students from lower-SES families have lower elementary and secondary school achievement levels than students from higher-SES families. When G-R estimate a probit model of post-secondary status (i.e., a model whose dependent variable takes the value 1 if the individual is enrolled in higher education and the value 0 otherwise), they find that parental occupation has a positive and significant coefficient, indicating that students from a "professional background" (i.e., whose parent(s) are professional) are more likely than students from other backgrounds to be participating. In the 1996 cohort, those from a professional background were 3 percentage points more likely to be enrolled in post-secondary institution. For the 2000 cohort, those from a professional background were 12 percentage points more likely to be enrolled. When student secondary school achievement was included for the 1996 cohort, parental occupation was no longer a significant determinant of participation. Instead, students with higher secondary school achievement were far more likely to attend than those with lower achievement. This suggests the common conclusion that the reason that lower-SES students have lower post-secondary participation is that low-SES is correlated (again, for whatever reason) with lower school achievement.

By contrast, when student achievement is added to the model for the 2000 cohort, the effect of "professional" parental occupation is reduced from twelve percentage points to six but remains significantly different from the effect of a "skilled" parental occupation. The effect of having parents in "non-manual" occupations also remains positive and significantly different from zero. G-R conclude that "over the period there was an increase in the impact of the social class variables and that this increased impact remained even after controlling for A level attainment and school type."

What does all this mean? G-R argue that income-driven educational inequality (i.e., the enrolment gaps between rich and poor students) has been increasing in the UK. But they believe, based on their own results and those of other researchers, that the increase in inequality predates the introduction of tuition fees. Moreover, they believe that "much of the impact from social class on university attendance actually occurs well before entry into higher education".

[38] Galindo-Rueda et al. (2004) p. 29

VI. Lessons for Canada

In Canada, as in the other countries under review here, tuition fees for post-secondary education have risen substantially in the past 10-15 years. The extent of the increase varies by province but all provinces have raised tuition since the early 1990s. Averaging across all provinces, tuition fees for university undergraduate arts majors rose from $1,866 in 1990-91 to $3,456 in 2000-2001, in constant $2001.[39] Within each province, fees are similar across institutions. However, in several provinces — and notably in Ontario — professional programs in medicine, dentistry and law can now charge higher and differential fees. For example, the average tuition in Canadian dentistry programs rose by 200% from 1995-1996 to 2000-20001, compared to 50% in all undergraduate programs.[40]

Canada has very high post-secondary participation rates. In each year from 1993 to 2001, roughly 60% of 18-24 year olds either had earned a post-secondary qualification or were currently enrolled in university or college. Roughly one-quarter of 18-24 year olds had participated in university education while another one-third had participated in college education.[41]

There have been several studies of the effects of Canadian tuition increases on the post-secondary participation rates of young people from varying parental socio-economic groups. With regard to undergraduate participation, the two most recent studies [Corak et al. (2003) and Drolet (2005)] arrive at the same conclusion using different data sets. Their two-fold conclusion is that: (1) young people from families with higher parental income or higher parental education are more likely to attend university but (2) these differences have not grown since the tuition increases began 10-15 years ago.

One possible reason for the relatively stable position of low-income students in this period of rising tuition fees is that the provincial and federal governments increased the amounts that student could borrow from subsidized loan programs. In Canada, student loans are mortgage-style loans rather than income-contingent repayment loans. As a result, increased borrowing — bachelors' graduates who borrow have an average cumulative debt of about C$18,000 — leads to higher monthly repayment requirements, regardless of the income of the former students. In a minority of cases, student loan repayment can cause severe hardship. In these cases, there are few escape routes. Student loans cannot be discharged in bankruptcy unless the bankruptcy is filed more than ten years after the student last left school. Government interest relief programs allow former students who have low income and high debt loads to suspend repayment for up to 54 months. However, only former students whose loans are in good standing (i.e., not in

[39] Drolet (2005), p.5, citing Corak et al. (2003).

[40] Frenette (2005), p. 6. Arguably, the variation in fees in professional programs across Canada — by province, program and institution — is wider than the variation in fees in any of the countries examined here.

[41] The exact proportions, as well as various definitional issues, are discussed in Drolet (2005). The particular proportions cited are drawn from Table 3 in Drolet (2005).

default) are eligible for interest relief. Those in the greatest difficulty, numbering in the tens of thousands, are far behind in their debt payments and have no possibility of relief.

This section summarizes several lessons that Canada might draw from the experience of Australia, New Zealand and the United Kingdom if it chooses to move in the direction of market provision. Before presenting those lessons, some of the similarities and differences between Canada and the other three countries are outlined.

Like the other three countries but unlike the United States, Canada's post-secondary system is almost entirely public. In addition, the Canadian universities are quite similar to each other (as are the Australian and New Zealand universities)
. Two universities in large Australian cities — the University of Sydney and the University of Melbourne — are perhaps a cut above the others; similarly, two of the universities that are perhaps a cut above the others — McGill University and the University of Toronto — are in Canada's largest cities.[42] Neither Australia, New Zealand or Canada has any of the elite institutions that exist in the United Kingdom (e.g., Oxford or Cambridge) or in the United States (e.g., Harvard University, Stanford University or the University of Chicago).

As is true in most OECD countries, there is a deep commitment to equality of opportunity in Canada, a commitment shared by Australia, New Zealand and the United Kingdom. The three former British colonies also share a special concern for the access of their Aboriginal populations.

Along with the common commitment to equality of opportunity is a commitment to mass higher education. While the crucial link between higher education and the job market is recognized in all the countries discussed here, there is also a widely recognized link between higher education and all sorts of academic endeavors that have little relationship to the market system — history, art and music are good examples. Moreover, universities in all of these countries are home to those who are critical of mainstream institutions, who can be relied on to think independently and who will try to influence contemporary affairs.

Finally, all of the countries considered here have well-developed tax collection systems. A key feature of existing income-contingent repayment loan systems is that repayment is made through the tax system once the borrowers have left school. This kind of collection substantially reduces the administrative costs associated with student loans.

The differences between Canada and the other countries are quite important when reform to post-secondary finance is being considered.

The first difference will be unsurprising. Federal-provincial relationships in Canada are much more complicated than in the other countries. New Zealand is a federal state with

[42] Judging the quality of universities is clearly a difficult exercise. The point of this comparison is only that there is some diversity in the quality of Australian and Canadian universities.

no close analogue to Canadian provinces. The central government in the United Kingdom has considerably more power in this area than does the Canadian government, although it should be noted that post-secondary funding in Scotland and Wales now differs in some ways from funding in England. Only Australia has states that are somewhat analogous to Canadian provinces (or American states). However, the Australian federal government long ago assumed a dominant role in post-secondary funding so that Canada alone is in the situation where fees cannot be set centrally (even if this deemed to be desirable). That said, a national income-contingent repayment loan system could be designed to replace the Canada Student Loans Program (perhaps with the same provisions for opting out that are now used by Québec and the Northwest Territories).

Second, Canada has had relatively high tuition fees and very high post-secondary participation for a long time. The Scandinavian model that characterized Australia, New Zealand and the United Kingdom in the 1980s has not existed in Canada for more than 50 years. The goals of any movement toward market provision would therefore be different since the expansion of post-secondary enrolments is not a major issue.

Third, Canada has had a student loan system since the 1960s. Moreover, Canada has had three different federal student loans systems since 1990 and each province has had its own student loan system. The implication is that Canada, unlike Australia and New Zealand, will have to consider how any new income-contingent repayment loans will interact with other outstanding student loans. That is, reforming existing systems can be quite a different enterprise than designing new ones. One major question that would have to be addressed is whether previously issued mortgage-style loans should be left in place, converted to income-contingent loans, or securitized and sold.

We now turn to a few lessons that Canada might learn from the experience of Australia, New Zealand, and the United Kingdom.

The political difficulty of significant movement toward a pure market system

One clear lesson from the experience of Australia, New Zealand and the United Kingdom is that the road to organizing post-secondary education along free market lines will be met with substantial political opposition.

Perhaps the story of the passage of the latest series of reforms in the United Kingdom can illustrate the depth of opposition that can be encountered. Up-front tuition fees of about £1,000 were introduced in 1998. At the same time, the maintenance grants that paid for students' living costs were abolished and replaced by means-tested income-contingent loans. In 2003, the Labour party proposed what they called "top-up" fees. Under this plan, universities would be able to set their own fees as long as the fees were kept below £3,000.

The initial proposal by the Labour government in January 2003 called for a maximum fee of £3,000 and the introduction of income-contingent repayment loans with no real interest and a threshold of £15,000. Modest maintenance grants of up to £1,000 per year

were to be reintroduced for students whose parents earned less than £10,000.[43] Opposition to the plan appeared immediately, not only from the opposition Conservative and Liberal Democratic parties, but also from within the ruling Labour party. Two objections were: (a) differential fees would threaten a situation in which "poorer students will go to cut-price, second rate universities, creating a two-tier system of higher education" and (b) the access of lower-income students would be impaired by higher fees and the inadequacy of the new maintenance grant program. Notice that the theoretical point of differential fees is to acknowledge the diversity of institutions and to distinguish among them. And the point of abolishing up-front fees and implementing income-contingent loans is precisely to allow poorer students to choose among universities without regard to cost. Nonetheless, the political opposition to the government's plan was widespread, both inside and outside of the Labour party.

At the end of November 2003, when the government attempted to push the new plan through Parliament, it faced a back-bench rebellion. As the Guardian reported on November 30:[44]

> More than 135 Labour MPs, including former Cabinet members Robin Cook and Clare Short, have already signed a motion against introducing [top-up] fees and, if the plans are left unchanged, the rebellion could be bigger than that against the Iraq war, when 139 Labour members voted against the Government.

To forestall the rebellion, the government negotiated with the rebels and, in the end, modified the proposal in several ways. Even with those concessions — including the promise of no further tuition fee increases until 2009 and only then after a bipartisan independent review, an increase to £1,500 in the maintenance grant and tuition subsidies for lower-income students — the bill passed Parliament on January 27, 2004 by a vote of only 316-311.

Interest rates

The charging of market interest rates on unpaid student loans is a fundamental element of most market-oriented theoretical models of post-secondary education. The reason is that subsidizing interest rates can be very expensive.

The current situation in Canada is that interest rates are charged on loans from the point of origination. However, students do not pay interest charges while they are in school full-time. Once they leave school, however, outstanding balances attract interest rates that are close to market rates. The interest rate charged on CSLP loans is just slightly above the prime rate. A subset of students who are having trouble with student loan repayment can qualify for Interest Relief programs run by the CSLP or by the provinces. In those programs, the government makes interest payments on behalf of the borrower, leaving the nominal balance unchanged.

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[43] http://education.guardian.co.uk/specialreports/tuitionfees/story/0,5500,879980,00.html

[44] http://education.guardian.co.uk/students/tuitionfees/story/0,12757,1097034,00.html

Neither Australia nor the United Kingdom ever charged real interest rates on their student loans, choosing instead to index outstanding balances to the rate of inflation. The immediate implication is that their income-contingent loan systems are considerably more expensive than they would be if real interest was charged. Estimates by Nicholas Barr in the UK context suggest that the lack of real interest means that only 50 percent of the real value of loans is ever recovered.

From 1992 to 1999, New Zealand avoided those costs by charging market interest rates. The lesson to be learned, however, is not about cost-saving but about the considerable political opposition that charging market interest rates generates among borrowers. That opposition easily translates into political pressure to eliminate the interest rates. As discussed above, a change to a Labour government in New Zealand in 1999 led to the institution of interest rate subsidies and, most recently, to the fulfillment of a campaign promise by a newly-re-elected Labour party to eliminate real interest altogether as of April 1, 2006. The current New Zealand situation represents a compromise in which borrowers who earn less than the income threshold pay no interest and those who earn more than the threshold are subsidized only to the extent necessary to ensure than 50 percent of each payment goes to pay down the loan principal.

Universality

In all three countries, income-contingent repayment loans are available to all students, regardless of their family income, to pay for tuition. In Canada, there was talk in 1995 about means-testing access to income-contingent loans. In an interview, Bruce Chapman emphasized the importance of making any income-contingent repayment loan plan universal. In the presence of heavy interest subsidies, however, universality will increase the cost of the system to the government. Thus the desire for a universal income-contingent loan system may conflict with the desire to subsidize the interest paid by borrowers. The theorists are clear on this point — market interest rates should be charged — but the political feasibility of such a plan is in doubt.

Increasing the diversity of institutions

One of the goals of moving toward a market system for post-secondary education is to increase the diversity of post-secondary institutions and to increase the extent of competition among the diverse institutions. As noted above, there is less diversity among Canadian post-secondary institutions than there is in the United States and the United Kingdom. A Canadian goal of increasing diversity may be driven by the three or four top-rated Canadian universities that hope to improve their standing even further by increasing fees, developing their own sources of revenue which might enable them to attract better faculty and to improve programmatic offerings.

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Table 1: Tuition Fees, 1989-2004, in Australia and England

Year	Australia	England
	(A$)	(£)
1989	1,800	0
1990	1,882	0
1991	1,993	0
1992	2,250	0
1993	2,328	0
1994	2,355	0
1995	2,355	0
1996	2,442	0
1997	3,300 4,700 5,500	0
1998	3,356 4,779 5,593	1,000
1999	3,409 4,855 5,682	1,025
2000	3,463 4,932 5,572	1,050
2001	3,521 5,015 5,870	1,075
2002	3,598 5,125 5,999	1,150
2003	3,680 5,242 6,136	1,125
2004	3,768 5,367 6,283	1,150

Table 2: Summary of Income-Contingent Repayment Loan Programs in Australia, New Zealand and England

	Australia	New Zealand	England
Universality	Students apply for places in the university system. They can be offered either a Commonwealth supported place or a fee-paying place. All those offered Commonwealth supported places are eligible for HECS, regardless of family income.	All students offered places in the university system are eligible for the income-contingent repayment loan program.	All students offered places in the university system are eligible for the income-contingent repayment loan program.
Interest rate	No real interest is charged on outstanding balances. Those balances increase, however, by the rate of inflation from the date on which the loan was issued. The existence of discounts for up-front payment or for payments greater than required creates an implicit interest rate.	No interest, real or nominal, is charged during the study period. In the post-schooling period, those whose income is below the income threshold pay no real interest but balances are adjusted by the rate of inflation. For those whose income is above the threshold, 7.0% interest is charged. However, any interest in excess of 50% of the payment is written off.	No real interest is charged on outstanding balances. Those balances increase, however, by the rate of inflation from the date on which the loan was issued.
Income threshold	Taxable income of A$36,184 which is equivalent to C$31,936.	Pre-tax income of NZ$16,588 which is equivalent to C$13,725	Pre-tax income of £15,000 which is equivalent to C$31,318
Repayment rates	For those above the income threshold, repayment rates range from 4% to 8% of income as income rises from A$36,185 to A$67,200. The repayment rate is applied to the full value of pre-tax income..	10% of the difference between pre-tax income and the income threshold of NZ$16,588	9% of the difference between pre-tax income and the income threshold of £15,000

Table 2 (continued)

Discount for up-front payment	A discount of 20% applies to HECS contributions paid up-front. In addition, if a borrower makes a voluntary payment in excess of A$500, he or she receives a 10% bonus (e.g., a A$500 voluntary payment reduce the outstanding balance by A$550).	No discount for up-front payments is available.	No discount for up-front payments is available.
Maximum repayment period	Until death.	Until death.	For 25 years after leaving school or until age 65.
Maximum amount available	Only the value of the HECS contribution can be borrowed. The amount of the contribution depends on the field of study chosen.	Students can borrow to pay tuition fees, course-related costs (up to a maximum of NZ$1,000) and living costs (up to a maximum of NZ150 per week of study).	Students can borrow any amount up to the value of their tuition fees (generally up to £3,000). In addition, students can borrow several thousand pounds to pay living costs. The maximum amount varies by income and by the where the student lives.
Treatment of loans in bankruptcy	Student loan debts are not dischargeable in bankruptcy.	Student loan debts are dischargeable in bankruptcy	Student loan debts are not dischargeable in bankruptcy.