

## **THE DIABOLICAL STUDENT LOAN PROBLEM**

The student loans scheme was introduced in 1992. It provided loans to tertiary students for tuition fees, and course-related and living costs. The loans were repayable (at the rate of 10 cents in the dollar) only when the borrower's income exceeded a threshold.

The scheme has become hugely politicised and concessional since then. During the 1999 election campaign the Labour Party promised to remove all interest charges while borrowers were in full-time study.

In a more outrageous election bribe, the Labour Party promised in 2005, apparently against the objections of finance minister Michael Cullen, to make the loans interest-free over their entire life, provided the borrower resides in New Zealand.

Steve Maharey asserted that Labour's election policies would not encourage students to borrow more. This was the height of naivety.

The loan uptake rate increased from 56 percent in 2006 to 71 percent in 2009, while the repayment rate decreased from 9.5 percent in 2005 to 7.3 percent in 2010.

The government is lending \$1.6 billion a year under the scheme, up a massive 50 percent over the last five years. The scheme's 630,000 borrowers – 18 percent of the population aged 15 years and over – owe more than \$12 billion.

The government wrote off 11 cents of every additional dollar advanced in the scheme's initial years. This rose to 23 cents after the 1999 election change and to 47 cents in 2009 when the loans were interest free for most students.

Subsequent moves by the National government will reduce the write off modestly to about 44 cents of every additional dollar lent.

The scheme's operating cost, which includes the write off of loans, exceeds \$800 million annually. It is equivalent to almost 20 percent of total operating spending on tertiary education and over 60 percent of such spending on police.

This rapid rise in the level of borrowings and operating costs was utterly predictable.

International experts on the financing of higher education viewed New Zealand's initial scheme as one of the best in the world. They have been dismayed by subsequent policy changes.

Spending on student loans has limited the level of funding available for other tertiary activities. It does nothing to improve the quality of teaching and research.

The present scheme entices students to squander educational opportunities and to be indifferent about the level of their student debt. It has extended the welfare system and suffers from a similar pathology to benefits, especially for borrowers living overseas.

In short, the Labour government bequeathed a diabolical problem to its successors.

The National government has tightened up the scheme. In the 2010 budget a lifetime limit for borrowing was introduced, while students with inadequate academic progress became ineligible.

In this year's budget the repayment income threshold was frozen at \$19,084 until 1 April 2015, instead of being indexed to inflation, the definition of income for the purposes of computing repayments was broadened, and an administration fee was introduced. Some other measures were also announced.

While commendable, the 2011 measures will only reduce the scheme's operating costs by about \$50 million a year. Fundamental change is required to contain its burgeoning cost and remove errant incentives.

In the wake of the global financial crisis and the Christchurch earthquakes 'business as usual' is an untenable option for present and future governments. Hard political choices are unavoidable. The longer they are delayed, the more difficult they will become.

The government should address spending programmes like the student loans scheme that provide inadequate value for the taxpayer's dollar. It should lead the community to a better understanding of the problems of the scheme and possible solutions.

Spending on tertiary education needs to be rebalanced. As most of the benefits of a tertiary education accrue to those who participate, the student rather than the taxpayer should bear the cost through tuition fees.

Some benefits flow to society generally and warrant taxpayer funding. They arise whether tertiary education is funded by student loans or not. Such assistance should be reflected in tuition subsidies rather than in a concessional loans scheme.

The loans scheme should facilitate access to tertiary education for students without other means of finance. It should not be used as a vehicle to subsidise tertiary education.

Students should pay a market interest rate. This would force them to weigh up the costs and benefits of their studies and encourage them to pay off their loans when they can rather than to defer repayment for as long as possible.

In the past incentives have been offered for students to pay off their loans. This provides additional subsidies for students who already benefit from one of the most generous loans schemes in the world. A better option is to enforce rigorously existing terms and conditions of the scheme and make the deferment of loan repayment less attractive to borrowers.

There is no easy way forward. However, the loans scheme must be put on a sustainable footing.

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