As addressed in an OPB Brief in November, data show that for most students college is not unaffordable in the sense that the cost is far outweighed by the increases in lifetime earnings and odds of employment. A larger problem is a loan system that concentrates repayment in the beginning of a graduate’s career when he or she is making the least amount of money. This problem comes into especially sharp relief during times of high unemployment and economic uncertainty.

The federal government currently offers loan repayment plans based on a graduate’s income (monthly payments are set as a fixed percentage of income) and that allow for a loan balance to be forgiven after 20 to 30 years of payments. These programs are available to people who meet certain requirements for income, and, in some cases, specific kinds of professions. However, now that the federal government has become the sole originator of all federal educational loans, such a program could be extended nationally, highly increasing the affordability of loan repayments by capping monthly payments based on income and ensuring that the loans will not follow citizens forever if they pay faithfully. The United Kingdom and Australia have both successfully implemented income contingent loan systems and both countries experience very little education debt default. Their approach to financing higher education is briefly described below.

**Australia**

Australia was the first country to introduce income-based higher education loans, in 1989. The government had abolished tuition fees entirely in 1973 but by the 1980s a small-government-oriented political climate and rising tax costs for higher education pushed a reform agenda that created of the HECS (Higher Education Contribution Scheme) whereby all undergraduate students who are Australian citizens face a uniform charge, which is paid back later based upon income. Payment of fees can be deferred via a government loan until graduates earn at least the average taxable income. The debt value is based on inflation and therefore does not accrue interest. The payments are collected by the tax authority and constitute a fixed proportion of income (ranging from four percent for lower earners to eight percent for higher earners).

The university fees started out at about 23 percent of the cost of instruction (with the government providing institutions the remainder), but have both increased and differentiated since implementation. Additionally, government funding for higher education has gone down significantly since the introduction of fees and the enrollment of full fee paying (as opposed to Commonwealth Funded Slots) domestic and international students has increased.

Australia’s fee system has undergone several reforms since implementation, including the:

- Introduction of differentiated fees by program (programs that lead to higher earnings now have higher fees).
- Ability for universities to set prices within a range set by the government (as opposed to the previous fixed fee).
- Ability for student to pay all fees upfront and receive a 10 percent discount (used to be 25% and then 20%).
- Ability for Australian citizens who do not gain entry to an enrollment slot funded by the government (‘commonwealth supported place’) to seek enrollment as a full fee paying student.
• Ability for full fee paying students to receive a form of income-contingent loan (FEE-HELP program) that is indexed to cpi (does not accrue interest) and carries an upfront loan fee of 20 percent.

However, there is a cap on some of these alternative revenue sources: Australian universities can only admit fee paying students once they have met their enrollment targets for government funded students and that total domestic fee paying students can not constitute more than 35 percent of undergraduates.

Ultimately, this system seems to work well in Australia, although the division of cost between the student and public has shifted much farther toward the student than before. The income based repayment structure and lack of interest accrual (whether in active repayment or not) brings low default rates and more affordable payments. One issue overlooked by the government was that Australians who leave the country to work elsewhere can stop paying without penalty and will not have to resume payments unless they move back. Over time this has been a more expensive problem than was initially anticipated and is one that should be addressed when structuring any similar system.

United Kingdom

Tuition fees first appeared in the United Kingdom in 1998 with a maximum annual fee of £1,000 depending on income. In 2004, the maximum fee was raised to £3,000, and to £3,290 in 2010. Universities facing budget cuts and rising costs claimed the need for more funding in order to maintain and increase excellence. This led to a report on the future of higher education funding in 2010 that recommended the government remove the annual cap on the tuition fees an institution could charge. Despite massive protests in 2010, the House of Commons approved an increase in the maximum annual fees to £9,000, which almost all universities have begun to charge.

As costs have risen in the UK, so has student debt. Students are able to cover the entire cost of fees with a government loan up front (not dependent on household income), which will be paid back once the graduate begins making over £21,000. The loans will accrue interest at the rate of inflation plus a percentage that is based on income (maximum of 3%). Monthly payments are capped at 9 percent of income. After 30 years of payments any remaining debt is cancelled by the government. This new and more progressive repayment system is anticipated to lower the total amount paid by up to 30 percent for the lowest earning graduates, but substantially increase total cost for the remainder (almost doubled for some). While the UK has had income based repayment since 1998, this huge spike in fees and change in repayment terms is brand new. The results will take time to unfold.

Making income based repayment available for more than just a select group of students can go a long way in restructuring education debt repayment so that it is less of a burden in the early part of a graduate’s career. However, it income-contingent loans do not resolve the underlying issue of rising educational costs. In fact, by stretching repayment out over a longer period of time, a graduate will face lower monthly payments, but end up paying even more for the education over the long run, especially as interest accrues. It is also important to consider the logistics of implementing such a system. Although an individual institution can become a direct lender, the complexity and costs associated with implementation, tracking and collections may be prohibitive. Such systems are usually implemented at the national level where most educational loans originate.