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Financing student loans in Thailand: revolving fund or open-ended commitment?

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Abstract

A student loans scheme (SLS) came into effect recently in Thailand, covering both upper secondary and tertiary level schooling. The central objective of the scheme is social — to increase access of poor students and to prevent student dropout. The loans scheme is highly subsidized owing to the extremely favorable repayment conditions, which in turn calls into question the longer-term financial viability of the scheme. The average repayment ratio on loans is only about 20%, while an overall loan recovery, taking into account repayment default and administration costs, is 10% or less. It is recommended that the loans scheme for the upper secondary schooling be converted to a grants scheme; alternative reforms are suggested to raise the average repayment and recovery ratios on loans for tertiary level students, closer in line with international experience.

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1. Introduction

A student loans scheme (SLS) has been established recently in Thailand, starting its operation in the academic year 1996/1997. As in the other countries where student loans schemes have been established, the Thai scheme covers tertiary education (comprising public and private universities, Rajabhat teacher training colleges and technical institutes); unusually, the Thai scheme also covers the upper secondary schooling. Throughout the world, student loans schemes almost exclusively relate to tertiary education; though there are a few notable exceptions.[1] Yet while loans schemes for upper secondary schooling are unusual, it is at this level of non-compulsory schooling that enrollment rates fall off drastically and the risk of dropout increases. Poor students are particularly at risk, because of the high opportunity costs of studying rather than working. For this reason, government subsidy of the private costs of upper secondary education, particularly for the poor, is seen as an important element of social policy in Thailand. A central question posed in this paper is whether subsidized loans targeted at the poor (rather than grants) constitute the best instrument for achieving the desired outcome.

Repayment conditions in the Thai SLS are extremely generous, implying an extensive loan subsidy. The introduction of soft terms of repayment may have resulted from the conception of the loan scheme as one that has essentially social objectives, with considerably less weight given to the financial aspects of the scheme. The open issue, however, is the resulting size of the loan subsidy; an overlarge subsidy brings into question the financial viability, and hence the long-term sustainability, of the scheme as a whole. Surprisingly, little attention

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[1] One is the Swedish loans scheme, but even here the loans element in the total aid package available to students is very small; another is the Japanese Scholarship Foundation, the most important source of financial assistance for students in the country, which covers both secondary school and higher education students.

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has been paid to this issue in Thailand. Yet the sums involved are very large; annual budgetary allocations for student loans now exceed 20 billion Baht (a sum equivalent to some 10% of the national education budget).

The plan of the paper is as follows. Sections 2 and 3 are contextual and comparative; Section 2 provides comparative data on the financial viability of loans schemes in other countries while Section 3 presents alternative objectives and policies for student loans schemes, based on international experience of student loans and contrasts this with the Thai scheme. Section 4 examines the size, growth and coverage of the scheme, in terms of financial commitments and number of borrowers. Section 5, focusing on the individual borrower's loan account, poses the question: how much of a loan does a typical student repay to the fund? Section 6 examines the financial viability of the scheme. It estimates the proportion of the loans budget that is likely to be recovered by the loans fund after taking account of the probability of repayment default and administration costs. Building on these findings, Sections 7 and 8 suggest reform measures that might be adopted for student loans at the upper secondary and tertiary levels, respectively.[2]

2. Financial viability of student loans schemes: international experience

Student loan programs have been developed in various forms in over 50 countries throughout the world.[3] Table 1 provides some comparative figures on the financial viability of loans schemes in about half of these countries. Estimates are provided on the average repayment on a typical loan, as expressed by the repayment ratio (present value of total repayments in relation to loan size) and of the recovery ratio (present value of net repayments, including repayment default and administration costs, in relation to loan size).

From the viewpoint of the individual borrower, the size of the subsidy received on the loan depends on the extent to which repayment conditions (interest rates, repayment linkage to inflation) depart from those on commercial loans. Following Johnstone (1986), we may regard this subsidy as a hidden grant to the student.[4] The lower the repayment ratio on an individual loan, the larger is the hidden grant element, and the more likely is the loan to be successful in encouraging educational enrollment of needy youngsters. However, lower hidden grants imply greater public subsidy.

Table 1
Recovery from student loans schemes, selected countries[a]

Country	Loan repayment ratio	Loan recovery ratio (including default and administrative costs)
Kenya	30	−3
Venezuela	7	−8
Chile	52	18
Honduras	49	27
Indonesia	43	29
Brazil	38	29
Ecuador	54	30
Jamaica	44	30
Bolivia	68	33
Denmark	48	38
Mexico	56	39
Japan	50	40
Peru	62	40
Australia	52	43
United States (GSL)	71	47
Finland	65	48
Guatemala	82	50
Norway	67	52
Colombia	71	53
Hong Kong	57	53
Dominican Republic	75	57
Province of Quebec, Canada	69	63
Barbados	87	67
Sweden	72	67

[a]Source: Carlson, 1992; Ziderman & Albrecht, 1995.

From the perspective of the government, the overall recovery rate depends not only on cash repayments (reflected in the size of the hidden grant received by students) but also on administrative costs (which are usually not passed on to the student) and the probability of repayment default. The financial efficacy of any loan program depends centrally on the size of the recovery ratio — the extent to which loans are repaid. It provides an indication of the program's efficiency in achieving cost recovery or, alternatively, the extent to which a loans program is subsidized. The recovery rate on student loans depends crucially on four main factors: whether repayments are linked to inflation; the amount of interest subsidy on the loans; repayment losses owing to non-repayment (default); and administrative costs.

It is apparent from the table that, in practice, few student loans schemes have proved to be financially viable,

[2] A broader discussion of many of the issues presented in this paper is given by Ziderman (1999), a paper prepared for UNESCO-Bangkok as part of the Asian Development Bank Social Sector Program for Thailand.

[3] For a concise overview of student loans in an international context, see Woodhall (1994). Also see Albrecht and Ziderman (1991, 1992, 1993) for applications to developing countries.

[4] Johnstone's classic discussion of student loans in the context of 'cost sharing' appears to be the first to define and calculate the hidden grant element in subsidized loans schemes.