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How do students finance human capital accumulation? The choice between borrowing and work

Costas Christou [a,*], Michael Haliassos [b]

[a] *International Monetary Fund, European Department, Washington, DC 20431, USA*
[b] *Goethe University Frankfurt, Germany*

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Abstract

Europe and other OECD countries are following in the footsteps of the United States in terms of charging costs of higher education to end users, while worrying about adverse consequences on access to higher education. Student loan and work opportunities can provide a way out, provided they are taken up by students in demographic groups of policy interest. This paper attempts to identify the demographic and financial profile of students who actually make use of such loan programs and/or of work opportunities in the US. We find that targeted demographic groups, such as students from low-income families, minorities, undergraduates, and married students do appear more likely than others to make use of loan and work opportunities, although not all groups exhibit the same preferences regarding loans versus work. Both the level and the composition of other available support, through grants and family transfers, are relevant for their financing choices. These findings on source effects can be of relevance when designing policies of direct grants to students or indirect support through tax and other benefits to parents. Proper design and targeting of student loan and work programs are particularly relevant for harmonizing funding policies for higher education in Europe, where free labor and student mobility may imply that some countries pay heavily for education while others attract educated workers due to higher returns.

JEL classification: I22; G2

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* Corresponding author. Tel.: +1 202 623 6743; fax: +1 202 589 6743.
E-mail address: cchristou@imf.org (C. Christou).

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1. Introduction

Recent policy debates on higher education have focused on two apparently conflicting policy objectives. On the one hand, OECD governments stress the importance of promoting access to higher education by wider segments of the population.[1] On the other, governments seem reluctant or unable to fund increased or even current levels of access through public support to Universities.[2] Faced with politically pressing alternative uses for public funds, governments increasingly favor charging end users of educational services, especially since the largest part of the return to higher education is estimated to be private rather than social. If anything, globalization and European integration intensify such tendencies. As Guille (2001) points out, lack of harmonization of EU funding policies for higher education, combined with free mobility of students and workers could result in students studying in countries where their financial contribution is more limited and then working in countries where returns are highest.

Given these considerations, there is increasing support for the view that European countries should rely more heavily on student fees, preferably differentiated by institution, rather than on public funding for financing higher education.[3] However, if increased reliance on student fees is to be reconciled with the policy objective to improve access to higher education, students ought to be given adequate opportunities to finance their education through loans and/or part-time work, in addition to any help provided through grants and through support from parents, spouse or other relatives. This has actually been the choice in the United States, which faced similar policy dilemmas earlier on.

Student loan programs and part-time work opportunities are indeed becoming increasingly important throughout the world. Albrecht and Ziderman (1993) identify fourteen programs in industrial countries, twenty in Latin America and the Caribbean, eight in Asia, four in the Middle East and Northern Africa, and seven in Sub-Saharan Africa, many of which were established in the 1980s.[4] More recently, Guille (2001) surveyed student financial aid programs in Europe and noted that more than half of the European countries studied, provide loans as part of total financial aid to students, while the proportion of beneficiaries varies from 10% to 80% of students.

Still, making loan schemes and work opportunities available does not automatically improve access to higher education, as there is no guarantee that these will be taken up by students belonging to demographic groups of policy interest. Who uses the programs is not only a function of government intentions and provisions to promote access, but also of the ability and willingness of students to understand and to take advantage of these opportunities.[5] It is also not clear a priori how participation in loans and work is influenced by the size and composition of

[1] Prominent statements of such policy objectives include the Dearing Committee (The National Committee of Inquiry into Higher Education) in the United Kingdom, the Committee on the Future of Student Support (College Toekomst Studiefinanciering) in The Netherlands, and OECD (1997).

[2] A prominent example of such policy orientation is the United Kingdom. While in the 1960s UK universities were almost entirely publicly funded, now direct public funding accounts for only about two thirds of total income on average (Greenaway & Haynes, 2003).

[3] See, for example, the nicely documented discussion in Greenaway and Haynes (2003).

[4] See also Woodhall (1991) and Johnstone (1986) for the extent of student loan programs.

[5] Recent literature on household portfolios has stressed the importance of inertia and informational considerations even in the context of portfolio decisions taken by mature households. See, for example, Perraudin and Sorensen (1991) on portfolios of financial assets, French and Poterba (1991) on international diversification, and Haliassos and Bertaut (1995) on direct and indirect stockholding.