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Income Contingent Loan Repayment Plans:

The False Promise of Fairness

Income Contingent Loan Repayment Plans (ICLRPs) have a controversial but prominent place in the history of student financial assistance in Canada. The idea, first proposed by neo-liberal economist Milton Friedman in 1955, is premised on two simple and related ideas: i) post-secondary education largely benefits the individual and, therefore, the individual should pay all or most of the costs; and ii) in order to feasibly shift the costs onto individuals, the repayment of the loan should be spread over a long period (Friedman suggested the student's entire working life) and geared to income.

Despite different national contexts and local nuances, ICLRPs have retained the founding elements sketched by Milton Friedman in 1955. In Canada, proposals for ICLRPs have caused fractious policy debates. In the early 1990s then NDP premier Bob Rae aggressively pushed ICLRPs as a model of student financial assistance but was thwarted by the lack of a willing partner at the federal level.[1] However, the idea was resurrected a few years later by then HRDC Minister Lloyd Axworthy's infamous program review. The plan was vigorously resisted by the Canadian Federation of Students and others and was eventually shelved.[2]

However, the plan returned again in full force with the release of Bob Rae's review of post-secondary education in Ontario in the fall of 2005. Rae returned to his failed quest to implement ICLRPs as Premier and called on the Ontario government to introduce a comprehensive system of ICLRPs. Rae's recommendation was substantially influenced by the radical reform of student financial assistance undertaken in the United Kingdom under the *Higher Education Act*.[3] Certain factions within the federal Conservative government have also long advocated ICLRPs, and several provincial governments, including Saskatchewan, Alberta, Ontario, and British Columbia, have seriously examined ICLRPs.

ICLRPs and the Financing of Post-Secondary Education

Though ICLRPs are often framed as a student financial aid issue, they are more accurately seen as a new way of financing post-secondary education. The initial impetus for ICLRPs was to increase the individual cost of post-secondary education while simultaneously reducing the government portion of funding. This defining element of ICLRPs is central to all of the more recent incarnations of the policy. The increase in the individual cost of post-secondary education shows up, of course, in tuition fee policy. In practice, ICLRPs encourage massive tuition fee hikes and the full deregulation of tuition fees.[4] In 1995, Lloyd Axworthy and the Liberal government largely lost the debate about ICLRPs because the proposal also involved cutting funding to the provinces,

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which in turn would lead to increased fees. Though fees are set provincially, Axworthy was forced to admit that under his plan the cuts in core funding would lead to substantially higher fees. More recently, in outlining his recommendations, Rae explicitly tied the introduction of ICLRPs to the deregulation of tuition fees.

The link between ICLRPs and shifting the burden of who pays for post-secondary education is most effectively captured in the following Human Resources Development Canada (HRDC) background paper on ICLRPs:

> ICR loan schemes… would solve the problem of university and college under-funding, by allowing institutions to increase tuition fees to cover a greater proportion, or even all of the costs. Fees would be unregulated and institutions would charge whatever the market would bear. Needy students and those with cash flow problems would pay the increased fees with the help of ICR loans.

This passage illustrates that one of the primary attractions of ICR for policy-makers is that it allows government to cut funding for post-secondary education and download the increased cost to the individual. [5]

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It is vital that ICLRPs not be viewed in isolation or as a modest reform of student financial assistance. Rather, it is part of a systematic and ideological shift in how post-secondary education is funded and the role of government in promoting equal access to college and university. When ICLRPs were first seriously proposed in the environment of austerity that characterized the Liberal government cuts in public funding, it was pitched as the tough medicine needed to institute fiscal discipline. ICLRPs have come a long way since then and most proponents of ICLRPs do not propose them as "the best of the bad alternatives" but rather as a magic bullet to what ails post-secondary education in Canada, and, more ambitiously, as the most just model of financing post-secondary education. However, despite such claims, ICLRPs are an indispensable element of a regressive policy agenda.

ICLRPs: A Wolf in Sheep's Clothing

The Rae Report's recommendation for ICLRPs and the C.D. Howe Institute's recent paper on ICLRPs, *The Case for Income Contingent Repayment Loans,* are useful starting points to describe the operational features of ICLRPs.[6] Rae's recommendations have resonated among influential government officials and bureaucrats across the country and both plans are representative of the ICLRP model of student financial assistance. Each proposal has the six core features that define ICLRPs: i) increased individual cost; ii) extended period of repayment, generally 25 years but some proposals would theoretically see some paying back a debt for their entire lives, including through retirement income; iii) flexibility in repayment that ties monthly payments to income; iv) the elimination of virtually all loan subsidies, including paying for in-study interest and repayment assistance after graduation; v) loosening or limiting the needs-based nature of student financial assistance so that virtually everyone is eligible for a loan; and vi) crafting the move to ICLRP as an urgently required solution to a 'crisis' in student financial assistance and as an effective way to promote access to post-secondary education for under-represented groups.

Although the founding principle of ICLRPs is that the individual should pay substantially more for post-secondary education, the underlying premise is that education is largely a private, consumer good that is over-subsidized by the state. Those who argue for higher fees often make the case that because those from high income families are over represented in the system any subsidy to lower or freeze fees is a regressive transfer to those who need it least. This questionable logic only holds up if one ignores the role that a progressive system of taxation plays in funding education on the front end and taxing those who benefit from post-secondary education on the back end. As Hugh Mackenzie has demonstrated, the Canadian system of progressive taxation ensures that lower tuition fees financed through public funding is always a progressive net transfer to those at the bottom of the economic ladder.

In addition, those who benefit from a post-secondary education in effect pay a premium for their education though higher taxes. In what Mackenzie calls the 'virtuous circle' of the inter-generational bargain, the additional revenue from those who do well in the labour market funds the subsided tuition and student financial assistance of those who come after them.[7]

In addition to Mackenzie's findings, a recent CAUT report found that for those in the bottom fifth of income tuition fees represent up to 67% of their after tax income. Under the current system of student financial assistance it is precisely those families at the bottom of the economic scale who are forced to borrow.[8] Despite the modest increases in grants that sometime accompany ICLRP proposals, it is these very same families that would bear the brunt of ICLRPs. Families in the bottom fifth of income are currently unable to afford the up-front cost of post-secondary education. The effect of ICLRPs on students from such families would be stark: much higher up-front cost, higher borrowing, and a repayment period that stretched through most of their working lives. Seen from this perspective, there is little fair or equitable about ICLRPs.

There is no evidence whatsoever that higher tuition fees is either fairer or more efficient than lowering fees for all accompanied by a generous system of student financial assistance for those from low income families. The *real politik* at play in the specious argument for the 'equity' of higher tuition fees is the promotion of a two-tiered system in which older established institutions could charge what the market would bear and the rest would fall behind with diminished public funding and fewer resources than the aspiring 'Harvards of the North'. This thinly veiled elitism lurks beneath virtually all arguments for higher tuition fees and ICLRPs are the student financial assistance model that enables this vision of financing post-secondary education.[9]

Defenders of ICLRPs universally point to the flexible terms of repayment that characterize most ICLRPs as evidence of their alleged efficiency and equity. Under most plans students would be given up to 25 years to repay a loan and the monthly payment would be geared to income. The rationale for this is the same as the founding logic of ICLRPs themselves which is that you can diminish the subsidy and increase the cost so long as the repayment period is long enough and the repayment is geared to income. The obvious advantage of such a system over the current fixed 10 year amortization policy is that it would reduce monthly payments and gear repayment to a graduate's actual income.

What is ignored, however, is that by rapidly and dramatically increasing fees you create the simultaneous need for a system of student financial assistance that extends the repayment period.[10] The irony is that the repayment difficulties students currently face is largely due to the doubling of tuition fees since 1990. Over the same period that fees skyrocketed, student debt rose from an average of $8,000 in 1990 to currently over $25,000 in some provinces. Introducing ICLRPs as a solution to a problem created by high tuition fees makes as much sense as fighting a fire with gasoline.

Though proponents tout the 20-25 year horizon of repayment as sensitive and generous, it is this very feature that allows for the introduction regressive policy measures that, in the long term, harm low income students the most. On a $25,000 loan amortized over 25 years a student would pay an additional $30,613 in interest alone for their education.

The allegedly generous terms of repayment are little more than a realistic acknowledgment that debt loads will be so onerous as to require longer repayment periods. It is precisely because of this dependent relationship that ICLRPs and a regime of higher fees are inseparable. This interdependence leads to some sanguine pronouncements about the massive increase in debt that students are forced to absorb under an ICLRP. The following argument by Nicholas Barr is representative of this Pollyanna view of debt:

> Many students are scared by the talk of up to £20,000 debt. But that figure should be seen in context. It seems large because we think of the expenditure on a weekly basis so it that cumulative totals seem shocking. But over a full career a typical graduate will pay £850,000 in income tax and national insurance contributions and will spend a half a million pounds on food. Quite rightly, nobody loses sleep over a career tax debt approaching £1 million because he/she looks at the figure through the other end of the telescope, in monthly terms. Student debt - given income contingent repayments - is no different.[11]

The argument here is similar to a typical sales pitch based on access to easy credit by downplaying the impact of higher costs by emphasizing the flexible, long-term nature of the repayment plan. It is also clear that this 'flexibility' and 'sensitivity' is central to making the case that students can and should take on a much greater share of the cost of their education. Such logic allows proponents of ICLRPs to gloss over the fact that under their plan the real cost of post-secondary education would massively increase. The argument rests on the claim that because the up-front cost is deferred, the actual cost of the ‘good’ is of no consequence. Again Barr is exemplary when he argues that under ICLRPs tuition "is free to the student; it is the graduate who pays." [12]

The argument for the fairness of ICLRPs is strained even further by its proponents when they argue against subsidizing interest while students are in-study. This subsidy currently costs federal and provincial governments over $200 million annually. The elimination of this subsidy would be directly downloaded to the individual along with higher tuition fees. Those who oppose subsidizing interest while students are in school argue that, under ICLRPs, covering the cost of interest is unnecessary because of the flexible horizon of repayment and the fact that payment is geared to income. What is also acknowledged is that part of the reason to not subsidize interest charges during the time a student is in school is that under ICLRPs, the cost of subsidizing interest charges would rise in line with the steep increase in fees and debt levels. Though proponents tout the 20-25 year horizon of repayment as sensitive and generous, it is this very feature that allows for the introduction regressive policy measures that, in the long term, harm low income students the most. On a $25,000 loan amortized over 25 years a student would pay an additional $30,613 in interest alone for their education.[13]

In response to these concerns, those who favour ICLRPs point to another central element of the scheme - gearing the minimum payment to a percentage of a graduate's actual post-graduation income, as opposed to the current arbitrary assessment of mandatory monthly payments. Though such a policy may ease short term difficulties in repayment, it is a regressive measure for two reasons. First, proponents of ICLRPs ignore the basic point that it is those from low and modest income families who are forced to borrow in the first place. As the CAUT study cited above outlines, current tuition fee levels ensure disproportionate levels of borrowing among low income families and ICLRPs would exacerbate this inequity by increasing the cost of borrowing and the up-front cost of post-secondary education. In addition, it is well documented that women, Aboriginals, first generation Canadians, and those from low-income backgrounds generally fare worse in the labour market. This is significant because it is those very people who fare worst in the labour who will take the longest to pay back a loan and, therefore, absorb the harshest possible interest penalty. The extended repayment period also ensures that those forced to borrow are saddled with debt most of their working lives, thereby reducing the possibility of obtaining the credit necessary to purchase a home or to save for their retirement and for their own children's education.

Even where proponents acknowledge the increased cost of tuition fees and borrowing as the price one must pay for a post-secondary education, they counter by suggesting that because ICLRPs relieve the worry of funding the up-front cost, more low income students will actually go on to post-secondary education. Guillemette rehearses this argument when he claims:[14]

> By lowering the variance in returns to post-secondary degrees for borrowers, and particularly by lowering the chance of making a very bad investment, income-contingent student loan repayments have the potential to encourage risk-averse individuals, particularly liquidity constrained individuals from poor socioeconomic backgrounds, to invest in them.

Guillemette's prediction is confounded by the empirical evidence. Research suggests the prospect of high debt deters low-income students from attending college and university. The *Youth In Transition Study* conducted by Statistics Canada found that for those who reported they faced a barrier to pursuing a post-secondary education, 70% cited finances. Though other factors were listed as barriers, many of those (e.g. those who said they did not pursue a post-secondary education because they needed to work or to care for a child) are proxies for financial barriers. These findings mirror an American study on the relationship between persistence and tuition fee increases. In one of the largest longitudinal studies of its kind, Michael Paulsen and Edward St. John found that for every $1000 of tuition fee hikes, low income students were 19% less likely to complete a program. [15]

Even more troublesome for Guillemette's claim is the evidence from England where the government has recently moved to a full income contingent system. The evidence again is that the high debt, high fee model is deterring low-income students. Applications are down sharply at high fee schools and a recent report by the Higher Education Statistics Agency (HESA) suggests that fewer low-income students are pursing post-secondary education since the introduction of the reforms.[16] HESA's study is particularly instructive because it notes that the government is properly informing students about the 'flexibility' of ICLRPs and the financing options available. It seems that higher fees and the prospects of higher debt are deterring students from disadvantaged backgrounds regardless of how 'generous' the terms of repayment are upon graduation. This finding is significant because of the claims commonly made by some that that the primary reason low-income students do not attend college and university is because they are not properly informed about the economic returns of a post-secondary education.[17] HESA's findings are backed by a study of 7,000 British high school students which found that nearly 30% were less likely to go on to university as a result of the introduction £3,000 fees.[18] Both studies add to the growing body of evidence that suggests that cost is the primary barrier for low income students and that ICLRP schemes would exacerbate the problem, not alleviate it.

Even when those students who are forced to borrow heavily fare well in the job market after graduation, the defining feature of ICLRPs will ensure they will pay a regressive supplemental tax not charged to those well off enough not to have to borrow. As Derek Price argues, any system that forces low-income students to borrow for an education undermines social equity:

> Low and lower-middle income students and black students [who borrow and] who successfully attain a college degree are paying more for post-secondary education and thus receive a lower return on their investment in higher education. In colloquial terms if you entered college in the smallest boat, you're probably in the smallest boat after you graduate... This chapter provides direct evidence that individuals may achieve upward mobility relative to their family's circumstances by receiving a bachelor's degree while at the same time the structural pattern of inequity among social groups during the life course continues to reflect race, ethnic, class, and gender characteristics.(5)[19]

Price directly counters any notion that ICLRPs are a socially just model of student financial assistance by pointing out how student debt replicates the patterns of race, class, gender, and ethnic inequity but hindering upward mobility. While gearing repayment to post-graduation income has the sheen of fairness, the façade disappears when access to post-secondary education is put into a large socio-economic context.

Conclusion

It is clear that ICLRPs are a regressive policy measure that would shift the burden of paying for post-secondary education and ensure that those who already struggle financially are saddled with a lifetime of debt. The alleged 'sensitivity' of these schemes is simply an attempt to smooth the rough political waters that would accompany a fundamental shift in how post-secondary education is funded.

In the end, ICLRPs offer a visceral reminder of two things: bold reform of student financial assistance is needed and ICLRPs are the least equitable option available. Those who peddle ICLRPs are surely correct that the current regime of high debt and arbitrarily high monthly payments is serving nobody well. Yet those who sell ICLRPs proclaim that we have two alternatives, accept the status quo or adopt ICLRPs. That Hobson's choice is little more than a manipulative tactic designed to foreclose alternative visions for funding post-secondary education. Fortunately the available options are much wider and more progressive. If we are serious about tackling the problem of student debt, then stabilizing and reducing tuition fees is a vital first step. Student financial assistance also needs to be recalibrated toward a system of non-repayable assistance so that those not fortunate enough to come from homes with the resources to help pay for an education, do not pay for that misfortunate by starting their working life with mortgage-sized debts. Such social goals will not easily fit inside the economic calculus offered by the likes of Bob Rae and the C.D. Howe Institute, but they are a good place to start if we want to restore hope in a system of post-secondary education that should be a path to opportunity rather than a road to 25 years of debt. ▪

Notes

[1] In Canada, with the exception of Quebec, the federal government funds and administers 60% of student financial assistance.

[2] See Edward Greenspon and Anthony Wilson Smith's book *Double Vision* for an account of this period and the debate over 'reforming' student financial assistance.

[3] For further reading see Nicholas Barr's *The Welfare State as Piggy Bank* (Oxford University Press, 2000). Barr was the architect of many of the reforms in the UK and offers a comprehensive argument for ICR from an economic perspective.

[4] Despite loud denials from Bob Rae and others that there is no 'inherent' link between ICR and higher fees his own program links the two and the international evidence overwhelmingly demonstrates that where ICR is introduced it is introduced as part of a rapid escalation of tuition fees. For further elaboration of this point see the Canadian Federation of Students' paper, *Income Contingent Loans: Inequity and Injustice on the Installment Plan* : http://www.cfs-fcee.ca/html/english/research/submissions/ICR-Inequality.pdf.

[5] Drawn from an internal discussion paper commissioned by Human Resources and Social Development Canada, obtained under the *Freedom of Information Act* by the Canadian Federation of Students, October 2005.

[6] The author, Yvan Guillmette, makes the argument for ICLRPs using economic jargon when he states that "at the margin, the value of public subsidies should be equal to the value of the externalities, with attendant price behaviour by institutions" (2). In other words, subsidies for public education should only kick in when the market price becomes so high that there are not enough consumers for the product. The defining problem with the neo-classical economic theory that underlies ICLRPs is that when you treat education as a market good you in effect suggest that only those with sufficient resources should have the 'right' to own the good. The CD Howe proposal of funding post-secondary education through ICRLPs radically undermines the notion of post-secondary education as a publicly funded collective good by portraying education as an entrepreneurial, individual activity. One of the most important assumptions that has informed public funding for post-secondary education in Canada is that access should be based on ability and ambition, and not on the ability to pay. Critically, ability to pay also means being free from onerous debt. Increasing the debt of students to pay for post-secondary education does not make post-secondary education more affordable - it merely defers the cost.

[7] See Hugh Mackenzie, *The Tuition Trap:* http://www.ocufa.on.ca/research_studies/tuition%20trap.pdf.

[8] See *The Economics of Access*: http://caut.ca/en/publications/educationreview/educationreview8-2.pdf.

[9] The Council of Ontario Universities (COU) has been one of the most active proponents of ICR in Canada. See Paul Davenport's "*Deregulation and Restructuring in Ontario's University System*." Also see William Watson's interview in *Policy Options* (September 2000) with then Principal of Queen's University, Bill Leggett. Leggett ruminates on his own peculiar version of choice and freedom: "In my ideal world, each institution in the system would be free to choose…some might choose to serve local needs and keep tuition low…Others may aspire to international levels of excellence and adjust tuition to levels consistent with that vision." Leggett's disingenuous argument for deregulation is matched only by former University of Toronto President Robert Prichard, who said: "Province wide I believe we'll see tuition both go up and go down as a more competitive market emerges among institutions offering different combinations of quality and cost." When fees for professional and graduate programs were deregulated, not a single institution reduced fees. At the University of Toronto Pritchard ushered in a regime of fees for the law school that will see fees go from $4000 to $22,000. What COU and others who favour ICR gloss over is the manner in which the deregulation of fees would exacerbate existing inequities between institutions and undermine quality at all but those institutions ready to compete in the 'free' market of tuition fees.

[10] When fees were deregulated in British Columbia they increased by 98% in two years. Before finally deciding to cap fees at the rate of inflation the BC government seriously contemplated an ICR model. In Ontario when fees were deregulated, fees in professional programs went as high as $17,000.

[11] *The Guardian,* June 12, 2003

[12] *The Welfare State as Piggy Bank,* p. 210.

[13] This figure is derived from using the current rate of interest on student loans (prime plus 2.5%) and assuming that the interest is not subsidized while in study.

[14] *The Case for Income Contingent Repayment Loans* (2):http://www.cdhowe.org/pdf/commentary_233.pdf

[15] See St. John, Edward and Paulsen, Michael B. "*Social Class and College Costs: Examining the Financial Nexus Between College Choice and Persistence.*" The Journal of Higher Education - Volume 73, Number 2, March/April 2002, pp. 189-236.

[16] See: http://www.hesa.ac.uk/products/pubs/home.htm

[17] The conservative US based think tank Educational Policy Institute (EPI) paper *A Little Bit of Knowledge is a Dangerous Thing* is emblematic of the attempt to explain away the effect of high debt and fees in determining access to post-secondary education. This paper is significant only in that it confirms a trend among those who favour higher debt and higher fees to argue that non-financial barriers like confidence and a lack of information are the real reasons why low income students don't go on to college and university.

[18] Approximately $6300 Cdn.

[19] *Borrowing Inequality: Race, Class, and Student Debt,* Lynn Reimer Publishers, October 2003.

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