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**Loan Financing to Higher Education: Experiences of
Bank Financing In A Less Developed Region**

Prof. Sailabala Debi

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CENTRE FOR MULTI-DISCIPLINARY DEVELOPMENT RESEARCH

Dr. B. R. Ambedkar nagar, Near Yalakkishetter Colony, Dharwad-580
004 (Karnataka, India)

Phone : 0836-2460453, 2460472

Website : www.cmdr.ac.in

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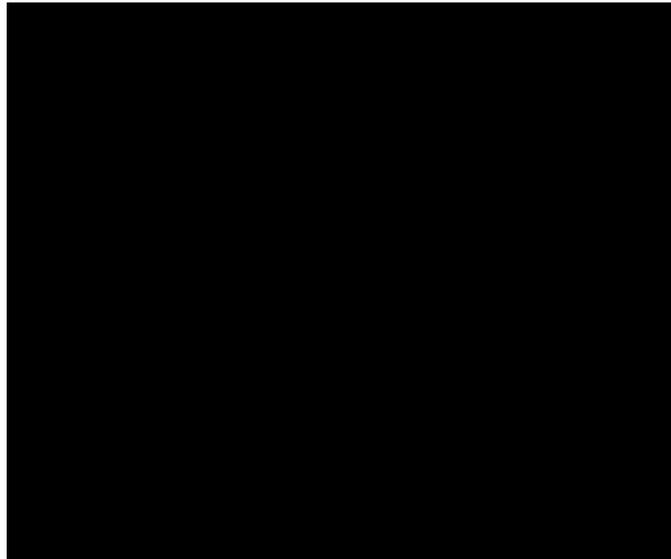
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Loan Financing to Higher Education: Experiences of Bank Financing In A Less Developed Region

Prof. Sailabala Debi

Introduction

Education is widely accepted as a basic human right. The goal of achieving UEE is now at the fore front of international policy agenda particularly in the context of Globalisation and MDG. Government of India and all the state governments have also taken up this agenda seriously and striving hard to achieve the goal. But one cannot ignore the role of higher education in general and technical higher education in particular to meet the competing challenges of Globalisation. Even within the education sector, relative priority assigned to higher education has been on the decline. It is to be realized that higher education institutions play an important role in setting the academic standard for primary and secondary education. They are also responsible for not only providing the specialized human capital in order to corner the gains from globalisation, but also for training the manpower inside the country, provide policy advice and so forth. Education is necessary for the development but higher education is essential for sustainable development. The influence of higher education on socio economic indicators is shown below:



1. Former Professor and Director, CMDR.

The author is thankful to Mr Atal B.Das and E.Mahesh for providing the statistical assistance. The author is responsible for the opinions expressed here.

The correlation values show that all the indicators are significantly related to higher education in terms of gross enrolment ratio and the higher education attainment. This shows the importance of higher education in influencing social and economic development.

The resources allocated to achieve the goals of education are found to be always fall short of the need. Education is considered as an important tool to enable the students with the right professional qualifications to get employment before they complete a particular course. These professional courses are expensive which many parents cannot afford. With expensive professional education becoming mandatory for entry into the assured job market, student loan seems to be the most effective way to help the students to go for expensive technical/professional higher education. Moreover, students are likely to be in a position to repay these loans over a period of time with the high salaries they would get immediately on qualification. Now student loans are one of the fastest-growing retail banking products. Almost all the public and private sector banks are offering student loans at attractive rates of interest to meritorious and needy students for studying in India as well as abroad.

In respect of funding pattern in the education sector by the government, it is observed that primary education is given the major share of resources by the government to achieve the goal of UEE within the stipulated time. The balance of resources earmarked for education is shared between secondary and higher education. In view of the recent declaration of Universalisation of Secondary Education, the share of resources next to primary level goes to secondary education and the resources allocated to higher education is the lowest within the education sector.

It is also observed that Government hardly spends less than one percent of the GNP on higher education. In 1950-51, 0.19 per cent of GNP was spent on higher education and it declined to 0.4 percent of GNP in 2004-05. This is largely attributed to the introduction of structural adjustment policies in the beginning of 1991 which included macroeconomic stabilization and adjustments where in a fiscal squeeze is experienced in almost all the sectors and the social sector is the worst affected sector particularly education and health. Since both primary and secondary education are prioritised in the budgetary allocation, higher education is the worst affected ones by the shrinking of budgetary allocation. On the one hand the demand for higher education has increased and on the other hand the allocation of resources was cut significantly. Thus there is a mismatch between the demand for higher education and the growth of government budget particularly after 1990s. This is not only a case in India but also in many other developing countries. According to UNESCO, during 1990s, 70 (63%) out of 111 countries reduced their share of public spending on higher education and 82 percent of them (34 out of 41) are only from developing countries. Sanyal and Martin, (2006) observed that some developing countries who has given the attention to the basic

education during past decade could focus on higher education, however, the majority of them had reduced their share in higher education. As the number of gross enrollment expanded massively, the funding per student from the government had decreased massively as well. Thus the situation is happened in all over the world whereas it being worse in developing and transitional countries. Thus in the overall context of (a) growing budget constraints in education, and (b) growing evidence in favour of priority for lower levels of education as against higher education, several influential reports and renowned academicians argued² strongly for reducing public subsidies for higher education. For example the World Bank as a promoter of an integrated world economy outlines its approach on financing higher education as: (i) to recover the public cost of higher education and reallocating government expenditure towards primary level with higher social returns; (ii) to promote education loans through the development of a credit market with selective scholarships, especially in higher education; and (iii) to decentralise the management of public education and encourage the expansion of non-government and community supported schools. Even the approach paper to the 10th Five-year Plan and 10th Plan document states that, "since budget resources are limited, and such resources as are available, need to be allocated to expanding primary education, it is important to recognise that the universities must make greater efforts to supplement resources from the government" (Government of India, 2001, 2002-2007). The overall thrust is therefore, to recover the public cost of higher education through exploration of alternative sources of financing. Accordingly attempts to find alternative methods of funding higher education have began in several developing countries. Among the various alternatives suggested, a system of financing higher education through student loans has been advocated as an innovative policy that promises reductions in the financial burden of higher education on government funds, and also improvements in equity in higher education, by reducing the regressive effects of public financing of higher education, and improving access to higher education (Tilak 1992).

There are many studies on student loans but not many research based analytical studies available in this area. In this background, the present study makes an attempt to examine the student loans through Banks to finance the higher education.

The issues raised in this respect are:

- What is the socio - economic background of the students taken loan?
- What is the repayment pattern of the loans?
- Is it a burden on the student or on the parents?
- Is the return to education of the loan holders higher?
- Does it meet specific manpower needs?
- Does the government further reduce the expenditure on higher education/ subsidy as a result of loan financing to higher education?

² George Psacharopoulos (1973) showed that the return to primary education is more than that of higher education, arguing in favour of reducing the extent of subsidisation as one climbs up the education ladder.

The present study seeks to examine the above issues with the help of an empirical study on bank loan financing for higher education in a less developed state i.e. Orissa. The paper is organized as follows: The first section presents the introduction describing the importance of higher education and the need for alternate funding. In the second section, some of the works related to student loans are discussed. The third section presents the study design including the methods of sampling and data analysis. The growth of higher education in India and the financing of higher education in India are presented in the fourth section. In the fifth section, loan financing to higher education in India is discussed. The Sixth Section presents the growth of higher education in Orissa and the financing of higher education in Orissa. In the seventh section the results of the empirical study conducted in Orissa on Bank loan finance for higher education are presented. The last section presents the main findings and concluding observations.

2. A brief Review of Literature

Recently, there are an increasing number of countries that have been implemented innovative financing to overcome the deficit in public budget for higher education. There are two general types of financing that utilized by governments around the world: direct financing and indirect financing. Direct financing is the transfer of resource directly to higher education institutions to support operational cost, capital investments, research, and specific purposes. On the other hand, indirect financing is the government finance support to student or their families through tax benefits, loan subsidies for academic and living expenses, grants and scholarships. There is another source of financing for higher education i.e. Private sector financing. This again is sub divided into private for profit and private not for profit financing. The financing by the households, Charitable trusts, Community etc. is included under not for profit category while the for profit financing category are corporate bodies, foreign universities etc.

Loan financing to education has emerged as one of the most popular alternatives sources of financing and this scheme is currently in operation in more than 80 countries around the globe. In view of the rising costs of higher education (both tuition fee and maintenance cost), a number of countries in the developing and developed world have established student loan programmes for providing the opportunity to the students of lower income class to go for higher education. This has become more popular sources of financing higher education mainly because (i) steep hike of cost of higher education, (ii) fast increasing demand for higher education, (iii) entry of private sector on a large scale.

More recently, commercial banking sector is an emerging source of student loan in countries, such as, India and China. No evidence exists on the nature and extent of other sources of student loan in any country. It was observed in China that the scheme does not act very equitably, since the chances of receiving a loan are lower for very needy students and differ amongst students of similar economic status depending on the educational institution. Since banks shoulder most of the default risk, they tend to discriminate against the more default-prone students - the poorer students and those enrolled in institutions of lower standing. It may also be noted that China fulfils both budgetary and social objectives of student loan scheme. In addition, since local governments provide the interest subsidy for local institutions, poorer local governments are less able to supply interest rate subsidies to local universities (Shen and Li,2003).

Chung (2003) states that the allocation of student loans in Hong Kong has been mainly based on considerations of equity, efficiency and adequacy. The students from less well-off families receive greater financial assistance. The loan entitlement varies according to a formula, which takes each applicant's family financial situation into consideration. The goal of the system is to ensure that no qualified student is deprived of higher education because of lack of funds which fulfils the social objectives. Second, the maximum amount of a loan is adjusted so as to correspond to the general living needs of a student through regular surveys of student expenses and the compilation of a Student Price Index. The allocation of financial assistance has also been used to encourage development in areas of study required by society. At different stages, various grants and loans in Hong Kong have been targeted at students in teacher training, information technology, financial services and creative media. Moreover, the development of the government student loans scheme has not reduced the government's financial commitment to higher education.

There are six government-supported loan schemes for higher education in the Republic of Korea, covering about 16 per cent of student enrolment. Overall, student loans in the Republic of Korea are highly subsidized and have not been used as a tool to support cost recovery in higher education (Kim and Lee,2003). Student loans have never operated on a large scale in the Philippines; their impact on higher education finance has been minimal and their performance record poor. Current experimentation with government funded but university-based loans schemes is also operated on a small scale with questionable success. No clear plans are afoot to develop any nationally based scheme of broad coverage and sizeable impact in the foreseeable future (Kitaevetal, 2003). However, the loan scheme in Philippines aims at targeting the poor students and the students pursuing priority courses.

Literature on student loan does include theoretical studies with a focus on alternative ways of designing and evaluation of student loans from the view points of efficiency and equity. For instance, Garcia-Penalora and Walder (2000) have examined the efficiency and equity implications of four instruments of financing higher education, viz. traditional tax subsidy schemes, a pure loan scheme, a system of income contingent loan and a graduate tax system. Using traditional tax-subsidy scheme as a bench mark scheme, the authors show that when the outcome of education process is certain, the three alternative systems are identical in self-financing of education by students. However, in the presence of uncertainty of outcome of education process, the three systems differed in repayment of cost of education.

Empirical studies on student loan in different countries provide with details of the objectives, design and implementation of alternative programmes or schemes. For instance, Johnstone (2002) presents an excellent review of student loan programmes in select Central America, European and African countries, such as, U.S.A, Sweden, Germany, Netherlands, U.K, South Africa and Kenya. Most recently, the experience of student loan schemes in Asian countries is elaborated in Shen and Li (2003) for China, Kim and Lee (2003) for republic of Korea, Ziderman (2003) for Thailand, Chung (2003) for Hongkong and Kitaevetal (2003) for Philippines.

The most important and common objectives of student loan are equity and access for the poor and cost-sharing has an implicit budgetary objective in regard to public funding replacement in higher education. That is, reduction in public expenditure on higher education and reallocation of education expenditure from higher to lower levels of education (UNESCO 2003). Notwithstanding the importance for budgetary objectives, however, the above studies do not offer a supporting or confronting empirical evidence on achieving the budgetary objectives.

Ziderman(2003) states that the Thai loans scheme, which began operating in 1996, is aimed at disadvantaged students, enrolled in upper secondary general and vocational schooling as well as tertiary education, in both the public and the private sector. While the scheme is aimed at the needy student, targeting is not effective. The family income ceiling set for loan eligibility is three times the income officially designated as defining poverty. Loan budget allocation to educational institutions is only very loosely tied to the social profile of the student population at a given institution (in the case of universities, allocation criteria are not based at all on student poverty within the university or related to need). The Thai loans scheme receives a considerably higher level of government subsidy than the loans schemes in the other case study countries.

Salmi and Hauptman (2006) argue that need-based grants and merit-based scholarships can be an important means to promote greater access, equity, and quality and can be

used to increase cost sharing regardless of whether the grants and scholarships are funded by government or through cross subsidies from other wealthier student. In higher education systems across the world, the trend toward increased cost sharing in public universities and the growth of private institutions have led to the creation of many ways to assist students in paying ever more of their own education and related expenses.

In the Indian context, Tilak (1999) argues that, from the view point of the governments, student loan are expected, among others, to do away with budgetary allocations for and eventually, withdraw from financing higher education or make higher education self-financing by non-government sources. However, Tilak underlines that this argument is based on several unrealistic assumptions, such as existence of well-developed capital markets and to their access for poor students, recovery of loans in specified periods; students are the main/sole beneficiaries of higher education and existence of strong or perfect links between education and employment. In the absence of these assumptions, Tilak concludes that student loan "may indeed be a deterrent to the growth of higher education".

In view of the experiences of India and other countries, student loans cannot be viewed as an efficient solution to the problem of finances in the short, medium and long term. Also it would not be a perfect substitute for budgetary subsidy to help the poor deserving students in higher education (Narayana,2001)

Tilak(2007) the loan scheme is not equity oriented and there is no evidence of preferential treatment for the socio-economically weaker sections. Even though banks offer one percent lower interest rates than the normal rate, but the student loan would work as a 'negative dowry' (Robbins Committee, 1963, p.211) particularly in the countries like India where dowry is a social phenomenon. After reviewing the strengths and weaknesses of the student loan scheme, Tilak (2007) suggested that student loan can be used in a very limited way for limited purposes but not for the whole higher education system in India. In the context of unequal socio economic background of Indian population, a sound taxation system can be allowed as an in-built mechanism of recovery of public investment made in higher education involved in the system of student loans.

The limited number of studies reviewed showed different results and so far no serious research based study has come out in respect of student loan financing particularly bank loan for educational finance. The present study makes an attempt to fill this gap in a limited way. But the study will be an eye opener to many of the issues which can be taken up as further research.

3.The Study Design

Both the secondary and primary data were used in the study. The secondary data pertaining to different indicators of higher education were collected and analysed. The indicators include number of universities and colleges of higher education, enrolment in higher education, budgetary allocation and expenditure pattern for higher education in different years for India and the study state i.e.Orissa.

In order to know the socio-economic impact of bank loan, its determinants and the rate of interest, mode of repayment etc we used primary data collected from the students already taken loan from banks particularly, State Bank of India in the district of Cuttack which is economically, educationally and commercially a developed district of the state. We took 60 beneficiaries availing bank loan for the purpose of pursuing their higher education. The list of beneficiaries was collected from the records of the Bank and they were selected randomly. We contacted the selected beneficiaries to provide the required information. The beneficiaries are from different branches of faculty like, B.Tech, M.Tech, MBA, MBBS and MCA etc. The information like their socio-economic background, educational qualification and their parent's education, occupation, residential status and mode of repayment of loan etc were collected from the bank records (from the forms submitted for the sanction of the loan). The primary data was collected through a questionnaire designed for the purpose. Besides many of the issues were captured through discussions with bank managers of different banks. Simple and cross tabular method were used to analyse the data of the socio economic and educational variables of the students taken loan. In order to examine the effect of socio-economic determinants of loan, a simple linear regression model was used as follows:

$$\text{LOAN} = F(\text{FATH_OCC}, \text{FAM_INCOME}, \text{INT_RATE})$$

$$\text{LOAN} = \alpha + \beta \text{FATH_OCC} + \beta_1 \text{FAM_INCOME} + \beta_2 \text{INT_RATE} + U$$

Where the dependent variable is loan taken by the student

FATH_OCC is taken as Service and others as dummy

i.e. 1, If the occupation is service, otherwise 0

FAM_INCOME is the family income.

INT_RATE is the rate of interest

α , β and U are the intercept, coefficient and error term respectively.

The returns to education were estimated through Mincerian earning function as follows:

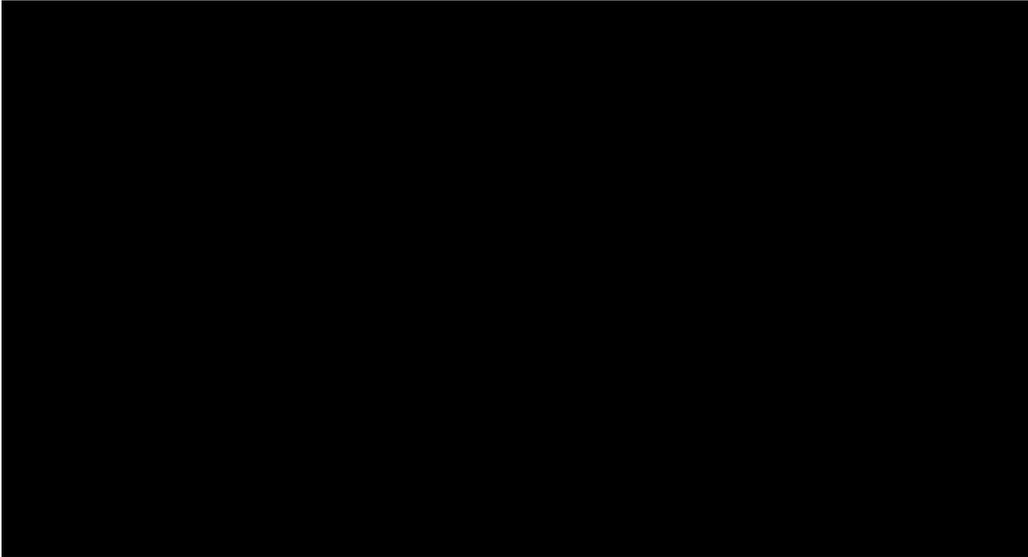
Log of earnings = f(years of education, years of education square)

By using this model we have estimated the returns to education of the students taken loan and compared it with that of students not taken loan. We collected the data purposively from 60 employed engineers and doctors in different types of jobs at Bhubaneswar. The number of students with loan and without loan was 30 in each category. Even though the sample size was very small, it provided some indication of returns to education financed through bank loan.

4. Brief Profile of Higher Education in India

4.1 Growth of Higher Education

Since independence, the number of colleges and universities has registered a significant hike. From 1950-51 to 2004-05 (Table 2), while the number of universities has increased at an annual compound growth rate of 4.9 per cent, the number of colleges has gone up from 578 to 17,625 showing a growth rate of 6.7 % per annum. During this period, enrolment in higher education has registered a steep hike, from around 0.174 million to 10.48 million. The gross enrolment ratio in higher education was 1 per cent in 1950-51 and it increased to 10 per cent in 2004-05. The number of teachers has also gone up from around 24,000 in 1950-51 to 4,72,000 in 2004-05 (Selected Educational Statistics 2006-07). As on March 31, 2006, the country had 20 central universities, 217 state universities, 102 deemed to be universities, 10 private universities, 13 institutions of national importance and five institutions established under the State Legislature Act (UGC 2006). Thus, the Indian higher education system is the largest in the world in terms of the number of institutions. The number of institutions in India is more than four times the total number of institutions both in the US and Europe.



4.2. Financing of Higher Education in India

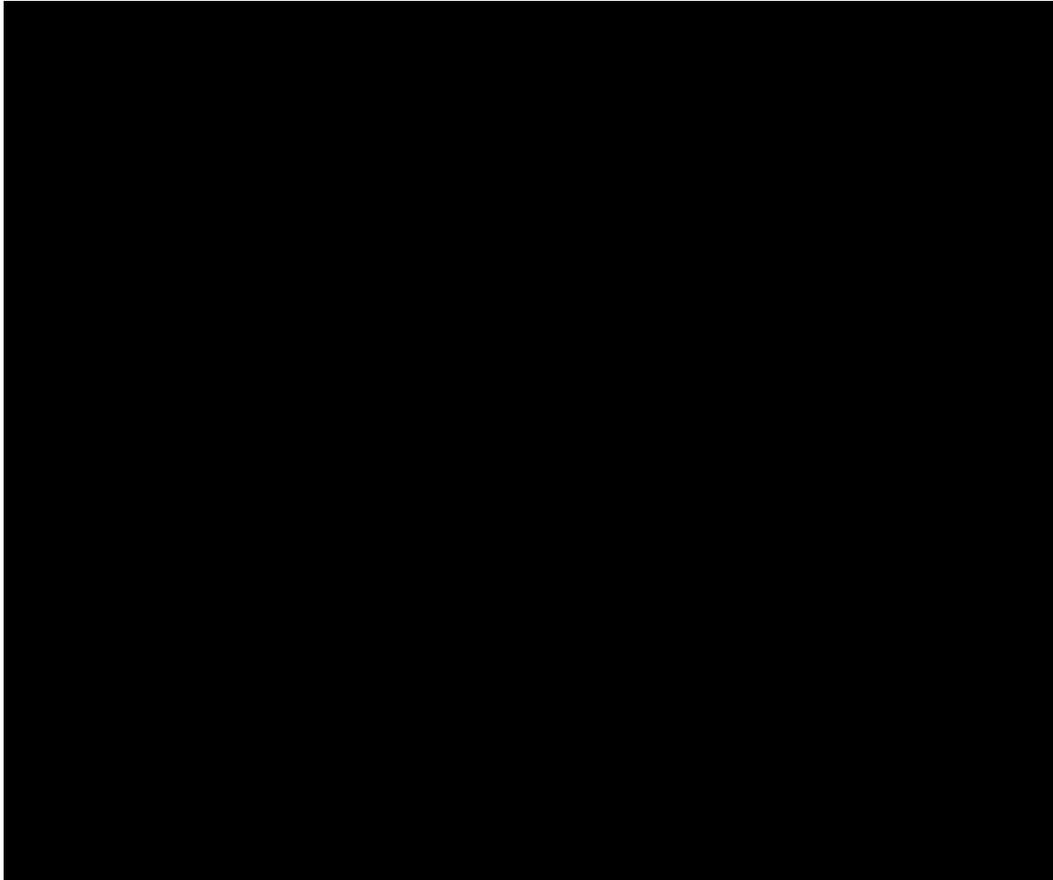
Before discussing the loan financing to higher education, the pattern of public expenditure to higher education merits discussion particularly during the fiscal stringency after 1990s at the national as well as at the state levels.

The main sources of finance of Indian Higher education is the government and the private that includes household, firms, community, charitable trusts etc. The long term trends in financing show that higher education is increasingly becoming a state funded activity with about three-quarters of the total expenditure being borne by the government. However, on account of several factors including the new economic policies adopted since the 1990s, state funding to education in general and higher education in particular, has been declining in real terms. Further, the mushroom growth of private institutions, particularly in areas of management, engineering, computers, etc, have raised the issues of access, equity, quality and regulation.

Public Expenditure on Higher Education

With the shrinking of government budget and other fiscal problems that both central and state governments are facing, the financing trends have not been favourable to higher education since the 1990s. The public expenditure on higher education increased from Rs 23,120 million in 1990-91 to 95,620 million in 2004-05 (see Table 3) at current prices with an annual growth rate of 12.3 per cent. To get a realistic picture, one may have to look at trends in public expenditure adjusted for inflation. After adjusting public expenditure both on higher and technical education for inflation with

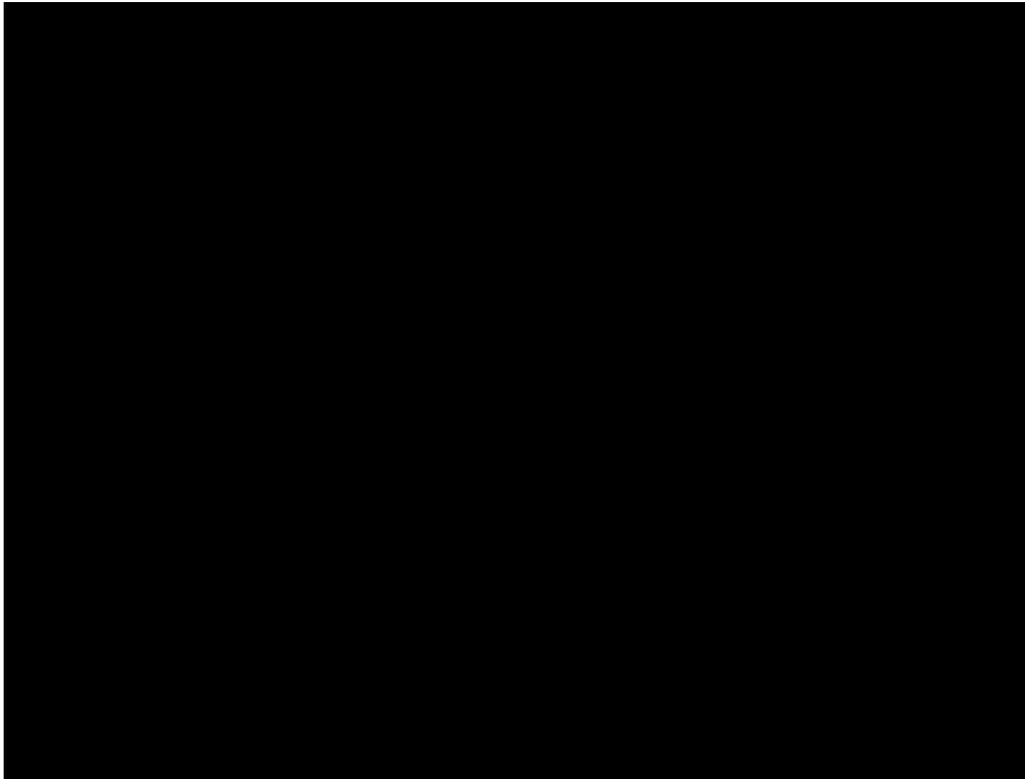
national income deflators, the annual growth rate turns out to be just 5.4 per cent and 5.2 per cent respectively (see Table 3).



The public expenditure by central government on higher education is around 20 per cent of the total expenditure since 1990-91 with a few exceptions in the present decade, wherein it increased to a little over 25 per cent. Much of the central government expenditure on higher education is routed through the University Grants Commission (UGC). It is interesting to note that the disbursement of funds by the UGC is uneven and the bulk of it goes to the central universities and their affiliated colleges and to a few deemed to be universities. Since 1990-91, the central and state governments are financing the public technical education almost in equal proportions. Much of the central government expenditure (a little over 40 per cent) goes to Indian Institutes of Technology (IITs). Further, Indian Institutes of Management (IIMs), Indian Institute of Science (IISc), National Institutes of Technology (NITs), and All India Council for Technical Education (AICTE) - each gets around 10 per cent of the total central government grants.

Proportion of GNP to Higher Education

One can not only judge the allocation of expenditure per se to higher education but also the proportion of expenditure on higher education to GNP/GDP. In the context of the intra-sectoral allocation of resources, it was observed that the constitutional commitment of providing universal elementary education is non- negotiable. The secondary education as a preparatory as well as terminal education cannot be ignored. In the context of globalisation and increased competition, the higher education cannot be overlooked either. Having regard to these realities, a consensus of a sort is gradually emerging to allocate at least 3 per cent of GNP to elementary education, 1.5 per cent to secondary education and the remaining 1.5 per cent to higher and technical education (CABE 2005). With this background, now let us examine the priority accorded to different levels of education. Since 1990s, the priority given to higher and technical education has declined despite their growing importance in facing the new global challenges. The proportion of GNP allocated to higher education has sharply declined from 0.46 per cent in 1990-91 to 0.34 per cent in 2004-05. The allocation to technical education declined from 0.15 per cent to 0.12 per cent as a proportion of GNP during the same period (see Table 4). The allocations to higher and technical education put together hardly constitute less than 1 percent (0.6 per cent of GNP) in 1990-91 and further declined to 0.46 per cent by 2004-05.



It is therefore quite clear that under the deep waves of globalisation and competition, important economic rationale for government funding especially for higher education is neglected. As Tilak(2003) has very rightly pointed out that the overall decline in public expenditure on higher education is attributed to (a) decline in resource capacity of the government, (b) neo liberal policies introduced in the beginning of 1990s and (c) a strong but a wrong assumption that higher education does not matter for development.

This adverse impact of economic reforms reflects upon various revenue diversification measures such as hike in student fees, entry of private sector into higher education, student loan programmes operated by commercial banks etc. One of the important revenue diversification measures adopted in the Indian higher education system is student loans. The student loan scheme has been in operation in India since 1963. In the next section we briefly present current model of student loan scheme and growth of student loan by commercial banks in India.

5. Loan Financing to Higher Education by Banks

5.1 Nature and Scope of Student Loan Scheme

Of late, educational loan is very popular among students because of its simple and appealing logic, despite its inherent weaknesses. It is argued that in order to safeguard the poor students from the rising costs of higher education (both tuition fee and maintenance cost), a number of countries in the developing and developed world have established student loan programmes. Student loans are currently in operation in more than 80 countries around the globe. However, cost recovery cannot be implemented equitably without scholarship programmes that should guarantee necessary financial support to academically qualified poor students (Salmi, 1992; Tilak, 1997). Further, imperfection in capital markets related to the lack of collateral security for education investments restricts the ability of poor students to borrow for education. In India, there was an interest free National Loan Scholarship programmes financed by the central government to help the poor and meritorious students in higher education. The recovery rate of this scheme was either extremely low or nil and the scheme is no more in operation.

Following the wave of changes around the world, the present Educational Loan Scheme through banks has become more popular. Government of India in consultation with RBI and Indian Bankers' Association framed a comprehensive loan scheme in 2001 and revised it in 2004-05. At present all the public sector banks and other private banks have introduced different types of attractive student loan schemes. The scheme covers a wide range of courses in higher studies from post-matric to higher studies,

both in India and abroad. However, to bring in uniformity and enlarge the scope of student loan scheme of all commercial banks, a model student loan scheme has been adopted by all commercial banks.

Student loans cover tuition fees, hostel fees, library charges, administrative charges, travel expenses, purchase of books/equipment /uniform etc. The amount of educational loans varies with different banks. Generally, the maximum limit granted is up to Rs 10 lakhs for studying inside the country and a maximum of Rs 20 lakhs for studying abroad. Loans are given on interest rates ranging from 10.5 to 15 percent per annum. Some banks also give a choice between fixed and floating interest rates. Some banks charge interest on a daily or monthly basis reducing the balance which works in favour of the borrower. Management students are among the top choices for most banks. Technology students from the country's premier institutions, medical and engineering college students can get student loans from banks on priority basis.

Eligible criteria

To be eligible for a student loan the applicant should be a resident and must have secured admission into a professional/technical course through a selection process. For studies inside the country banks lend up to Rs 4 lakhs without providing any security or margin. For a higher loan amount of say up to Rs 7.5 lakhs can be availed against a third party guarantee. The third party guarantee can come from a person standing guarantee for the full amount. This loan comes with a five percent margin (what this means is that five percent is deducted from the amount sanctioned as loan). Margins vary from 5 per cent to 15 per cent for loans above Rs.4 lakhs. Interest rate is charged according to the Prime Lending Rate (PLR) for loans up to Rs.4 lakhs and with one per cent addition to PLR for loans exceeding Rs.4 lakhs. This rate is one percent less for the girl students.

To study abroad, a higher loan amount of Rs 7 lakhs and above are usually sanctioned against fixed deposits, NSC certificates, or property worth the loan amount. Here, the margin amount is 15 percent. Further, a loan below Rs 4 lakhs is charged at 10.5 percent rate of interest, the interest on a loan over Rs 4 lakhs is usually charged one percent higher. The Reserve Bank of India (RBI) prescribes the specifics (amount, rate, repayment period) of education loans and the government provides a two percent subsidy on these loans to banks.

Documents required for a student loan:

Completed education loan application form Original mark sheets of last qualifying examination Proof of admission, scholarship , studentship etc Prospectus of the institute

containing schedule of expenses for the specified course Passport size photographs Borrower's bank account statement for the last six months In case the borrower in an income tax payee, income tax assessment order of last two years brief statement of assets and liabilities, and of the co-borrower, if any Proof of income (salary slips, Form 16 etc), if any Copies of foreign exchange permit, if applicable.

Repayment

Ideally, a loan from a bank located close to place of study should be taken unless it is concerned with overseas studies. This facilitates easier access to funds. For courses where employment prospects are less (as per the bank's own evaluation), loans are sanctioned on the basis of the parents' income. The Indian Banks' Association (IBA) has recently formed a working group to address the issue of student loans and the rising rate of default. The group has submitted its findings to the Reserve Bank of India and the main suggestion is to make it mandatory for parents or guardians, of the student availing the loan, to be co borrowers , thereby making them liable for repayment. Loans are usually repaid through equated monthly installments (EMIs). It generally commences after one year of the completion of course or six months after securing the job. The time period can vary depending on the policies of the bank. On an average period of repayment of the loan for a student is spread over 10-11 years.

Tax implications

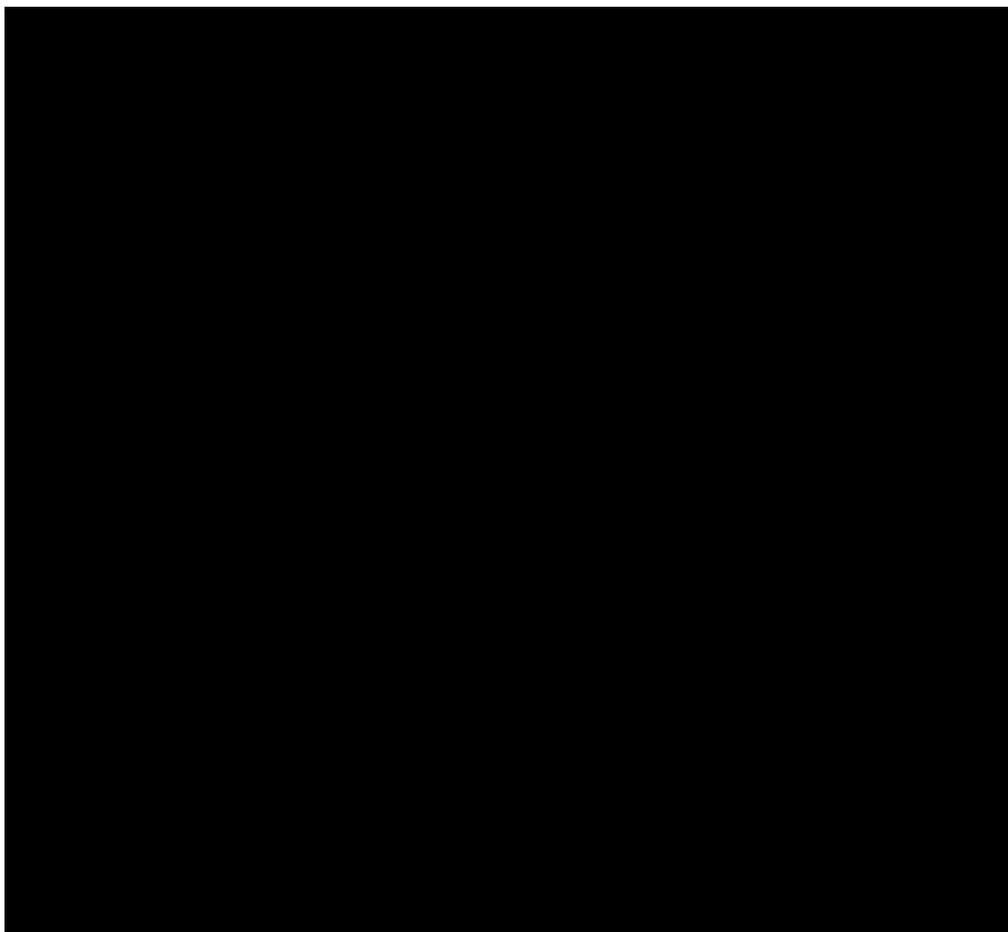
Under Section 80(e) of the existing Income Tax Act, a person can exempt the amount paid against the interest of an education loan - either for self, spouse or children - for eight years from the year he starts to repay the loan or for the duration the loan is in effect, whichever is lesser. The yearly limit for deduction is Rs 40,000 (for both the principal and interest) since 2005 and it was Rs 25000 earlier. The student loan segment is being viewed as a vast untapped potential. Almost every prominent bank in the country has a student loan scheme in some form. Banks are increasing the flexibility of this loan in terms of payback period to attract more students. Therefore, it makes sense for students perusing professional courses to opt for a student loan.

5.2. Growth of Student Loan

Education is one of the 18 sectors³ under priority sector lending by the commercial banks. Published data on educational sector leading by commercial banks is limited

3 The other seventeen priority sectors are: i) Agriculture, ii) Small Scale Industries, iii) Micro and Small Enterprises, iv) Setting up of Industrial Estate, v) Small Road and Water Transport, vi) Operators, Retail trade, vii) Small business, viii) Professional and Self employed persons, ix) Micro Credit, x)Consumption, xi) State Sponsored Corporations/Organisations for on-lending to other priority sector, xii) State sponsored organisation for SC/ST for purchase and supply of inputs and marketing of outputs, xiii) Housing loans, xiv) Funds provided to RRBs, xv) Advances to self-help groups, xvi) Advances to software industries, xvii) Advances to food and agro- processing sectors.

to public sector banks and relate to the number of accounts and amount of education loan (i.e. amount outstanding)⁴. According to Trend and Progress of Banking in India (2008-09), as on March 2009 there were 27 public sector banks, 22 private sector banks and 27 foreign banks in India provide education loans. Published data on educational sector lending by commercial banks is limited to public sector banks and relate to the number of accounts and amount of education loan (i.e. amount outstanding). Table 5 presents the growth of student loan from 1990-91 through 2008-09.



As it can be noticed from Table 5 over the years, the number of accounts in the country shows wide fluctuations in terms of annual growth rate. The annual growth was negative in 1990-91, 1991-92, 1992-93, 1997-98, and 1999-2000, zero in 1993-94 and positive in rest of the years. On the other hand, the amount of loan has increased as indicated by the positive annual growth. However, variations in annual growth rate indicate lack of consistency in the annual increase in amount of the loans. Further,

⁴ According to provisional data available from RBI, as on March 2009 the educational sector lending by private sector banks is Rs. 797 Crores, which is just 0.42% of the total priority sector lending.

of the total priority sector lending by public sector banks, student loan has remained less than one percent throughout the period until 2001-02. Nonetheless, after 2001-02, there has been a considerable improvement in student loans.

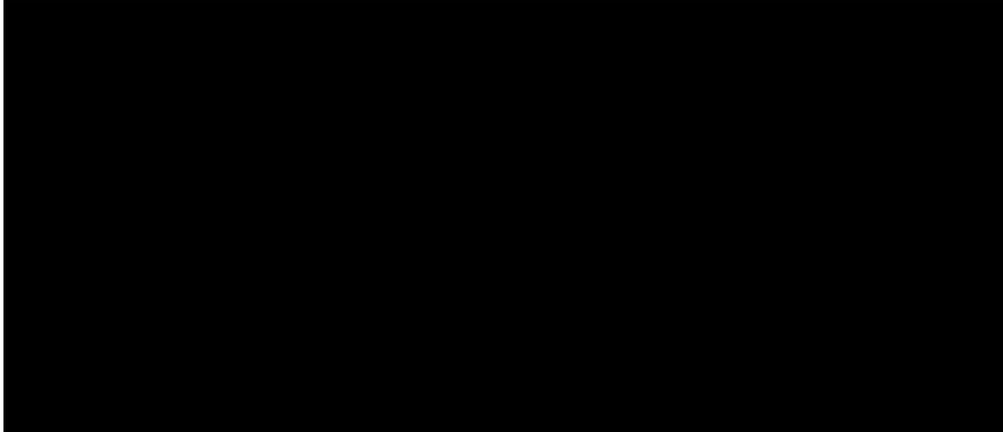
6. Student Loans by Banks in Orissa: A Case Study

Before discussing the student loans in higher education in Orissa, it is necessary to have a brief idea about the status of higher education in the state of Orissa.

6.1 Growth of Higher Education in Orissa

Orissaa is considered as one of the backward states of the country with highest proportion of its population living below poverty line. The demographic composition of the state makes the state to become more backward as about 40 percent of its population constitutes SC and ST. The female literacy rate among the ST population in some of the ST pockets is still below 10 per cent. In the context of wide socio economic and political disparities it would be interesting to examine the status of higher education in the state.

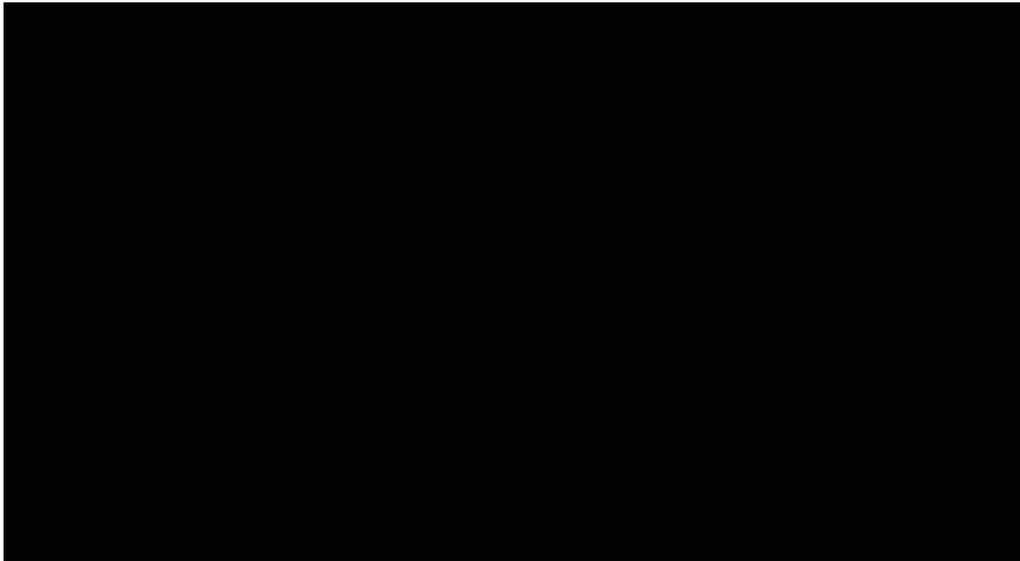
When the new state of Orissa was formed in 1936, there were only five colleges in the state. Of these 4 were Arts and Science colleges and one training college for teachers. In 1943 the Utkal University was established and higher education began to expand. At the time of independence there were only 11 arts and science colleges and one medical college. The total enrolment was 3885 out of which 219 were girls. The number of colleges increased to 14 including one Women's college with an enrolment of 6252 at the beginning of the First plan (1950-51). Despite considerable expansions in higher education in Orissa since independence still the state is behind many of the states and national average. There are 9 universities, 2 deemed universities and 3 research Institutes in Orissa in 2005-06. The colleges grew at an average compound growth rate of 7.4 during 195-01 to 2005-06. Total number of institutions of all types grew at 7.92 % per annum during the same period. The enrolment increased at a higher compound growth rate of 7.92 per cent than the institutions which gives an idea that some of the colleges might be overcrowded. This shows the increased demand for higher education. The proportion of enrolment in higher education is about 5 per cent of the concerned age group of population which is less than the national average of 10 percent. This enrolment is much lower for SC, ST and women in the state. Table 6 presents the growth of higher education in Orissa.



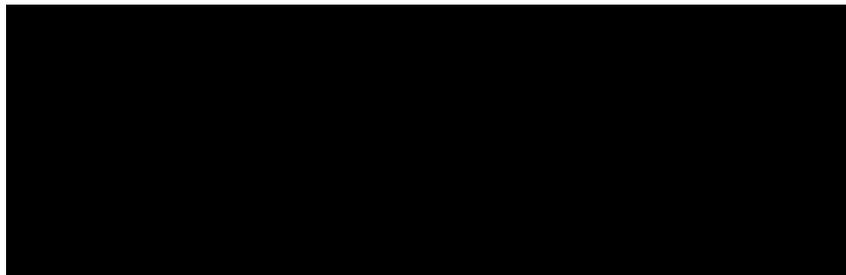
6.2. Financing of Higher Education in Orissa

Financing of education in the state has been a recurring problem since independence. The resources allocated to education in the state are quite inadequate for qualitative and quantitative development of education in general and higher education in particular. The total expenditure on higher education in the state has always remained less than 3 per cent of the total state expenditure. It was 2.19 per cent in 2000-01 while the same has declined to 2.13 per cent in 2008-09. There is slight improvement in the allocation to higher education in 2009-10 but it is less than 3 percent.

Not only the expenditure on higher education to the total expenditure of the state is very low but also the proportion of expenditure on higher education to total expenditure on education is not very encouraging. It was 12.37 per cent in 2000-01 and it increased to little more than 16 per cent in 2009-10. One can also examine the share of educational expenditure in state income and it is found that much less than one percent of the GSDP is spent on higher education. It was 0.45 percent of the GSDP in 2000-01 and increased to 0.60 per cent in 2009-10. Table 7 shows the expenditure on higher education.



The allocation of resources between different sectors of education shows that primary education always gets the highest share and higher education the lowest share (Table 8). Not only the allocation to higher education is lower than primary and secondary but also the expenditure on higher education has remained more or less constant over the years.



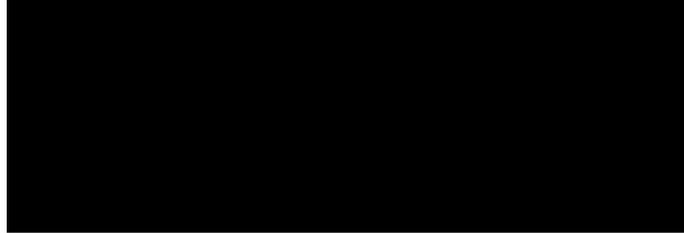
6.3. Bank loans for Higher Education: Empirical Data Analysis

As mentioned earlier the information collected from a sample of 60 students who took loans from the State Bank of India. The socio economic profile of the loan holders and other such information were collected and analysed.

Loan holders by Social Groups and Gender

More than half of the loan holders are general castes, little more than 40 per cent of the loan holders belong to OBC and only 3 percent are scheduled castes. The least proportion of backward castes is found to get loans from the bank. Of the total

loan holders 73 percent are males and the rest are females. Table 9 presents the loan holders by social groups and by gender and by castes.



Loan by Type of Education and Gender

The average loan amount is the highest for MBBS degree followed by M.Tech degree. The lowest amount of loan is found for the diploma course. Across gender the loan is always found to be lower for females than their male counterparts. The general assumption that bank loan is equity oriented does not seem to be a correct assumption as evident from our empirical data. It not only affects the women's higher education but also the socio economically backward and SC/ST students, because there is no specific scheme by the banks for these groups of population.

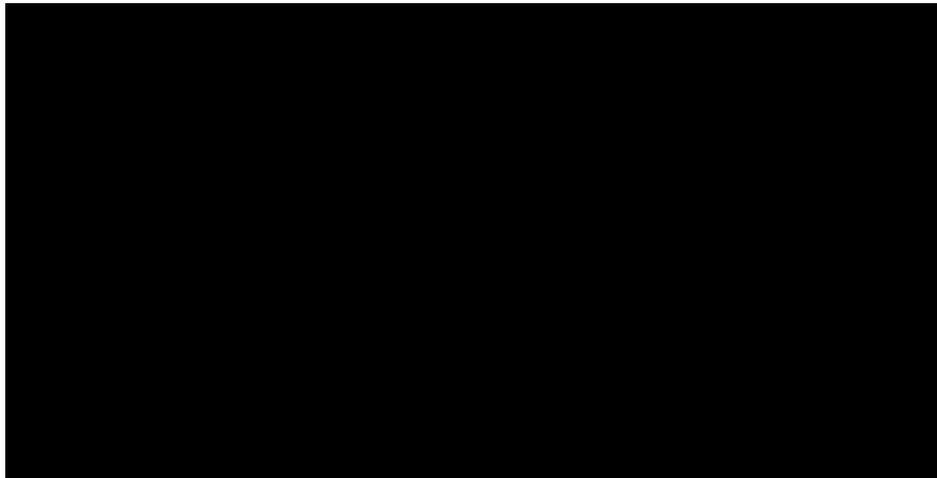
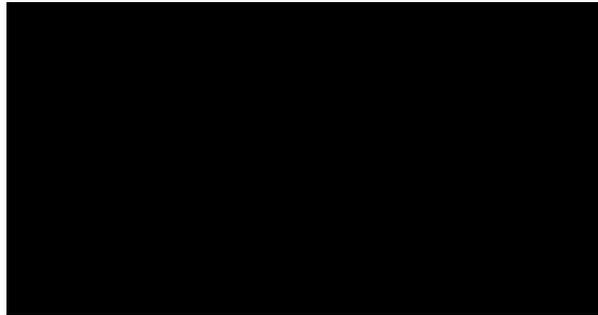
Education Loan by Father's Occupation

About 2/3rd of the students are getting loans when father's occupation is service and 30 percent of the students belong to the business community and only 3 per cent are from cultivator's family. The amount of loan taken by the students belonging to cultivator's family is not only the lowest but also it was taken for diploma courses which is below the degree level of technical education. It may be on account of the affordability of the father as well as the repayment capacity of the father in case the student cannot pay back the loan after the completion of education. It may also be noted that the fathers with service prefer to send their ward for higher professional degree courses with the expectation that they will be employed after the study is over. Since these courses are costlier they prefer to take bank loan which is easily available to them because of the repayment guarantee by the father. Also the service holder fathers prefer loan for the education of their ward for tax relief. Table 11 presents the distribution of loan holders by father's occupation.



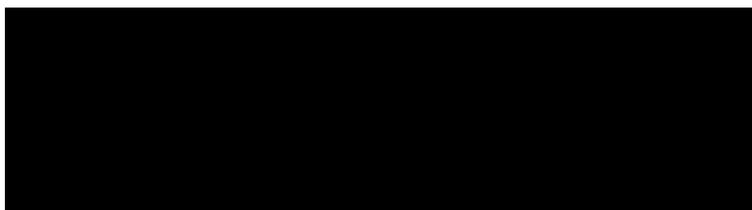
Loan by income of the Households

It is noticed that the amount of loan and the income of the family are directly related. As the level of income increases the loan amount also increases. Table 12 and chart - 1 present the loan and the income level of the households.

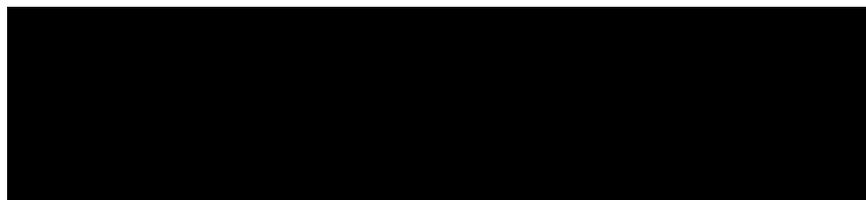


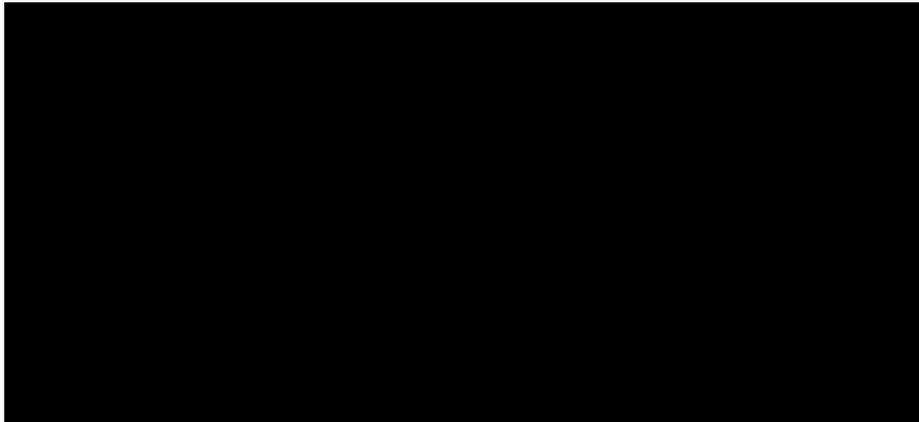
Loan by Collateral and defaulters of loan

In order to test the norm of the bank that up to Rs 400000=00, no collateral is required for the sanction of loan and beyond Rs 4,00,000/ some collateral is necessary. This norm is in order in case of our sample customers. About 57 per cent of the loan holders got the loan without collateral and 43 per cent got it with collateral as the average amount of loan in this case is more than Rs 8 lakhs. **Most interestingly it was observed that the proportion of defaulters is higher when there is no collateral.** The percentage of defaulters is 29 percent without collateral and only 7 percent in case of loan with collateral. If they are not able to repay the loan, the bank may take away their security for which they are regular in their repayment of loans. Table 13 presents this aspect.



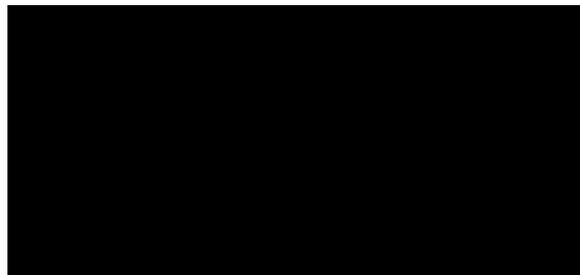
It is also a fact that better the economic status of the households, higher is the amount of default of loan. This is established from our empirical study. Table -14 and Chart-2 show the linkage between income, occupation and default amount of loan of the loan holders. It is found that with the occupation as service and higher average income of the households, the default amount is also the highest. The default amount is the lowest when the occupation is cultivation with lowest income. This shows that Banks favour not only the assured income group to sanction the loan amount but also the highest income group which is again a threat to equity of education.





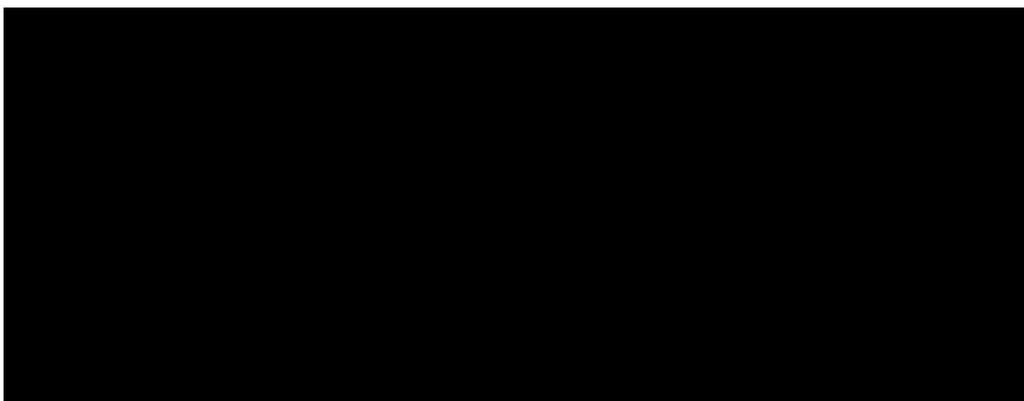
Rate of Interest and the Loan Size

There are lot of variations in the rate of interest charged by the bank for the sanction of the loan to a student (the details are discussed in the earlier section). The interest rate varies from 8 per cent to more than 14 per cent. There is an inverse relationship between the amount of the loan and the rate of interest (Table-15).



Moratorium Period and the Repayment Period of the Loan

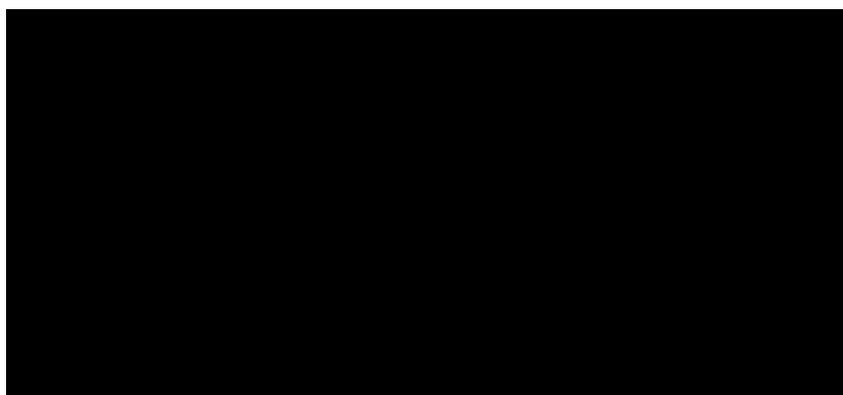
The moratorium period of the loan starts after the study period which varies from 24 to 72 months. This grace period of the loan is given to the students with the assumption that they may not get employment just after passing out. The repayment of the loan is to be made with minimum 36 months to a maximum of 84 months. This gives a clear indication that there is sufficient flexibility for the loan holders to repay the loan. If one takes the minimum moratorium and the minimum repayment period it comes to 70 months (24+36) which seems to be quite convenient for the loan holder to repay the loan.



6.4. Results of the Statistical Model

Effect of Socio Economic variables on loan

As discussed earlier we have attempted to examine the issue of determinants of bank loan through regression model. The results of regression show that the loan is influenced positively by family income and father's occupation while the same is influenced negatively by interest rate. Both the coefficients are found to be statistically significant also. We incorporated caste and sex in the model and both the variables were not found to be the influential factors of the loan. The coefficient values came out to be very negligible and also statistically not significant for which we dropped these two variables. Table -17 presents the regression results.



Effects of Education on Earnings

We tried to estimate the influence of education of the loan holders on their earnings. For this we have considered only two types of graduates i.e engineering and medical graduates. The net of earnings of these graduates are considered after adjusting the loan repayment amount. The following Mincerian (1974) earning function was fitted:

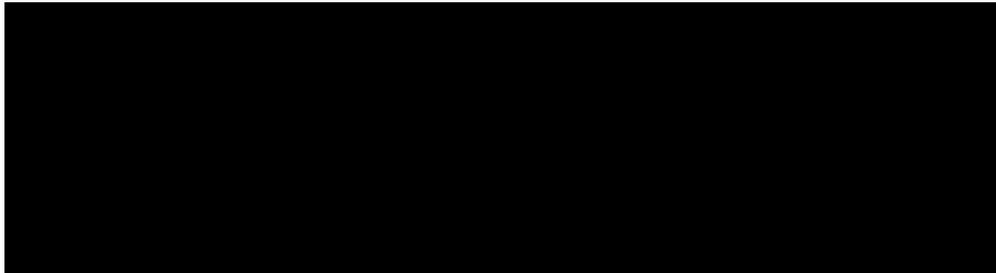
$$\text{Log of earnings} = f(\text{Education, Education Square}) = \alpha + \beta \text{EDN} + \beta_1 \text{EDN Square} + U$$

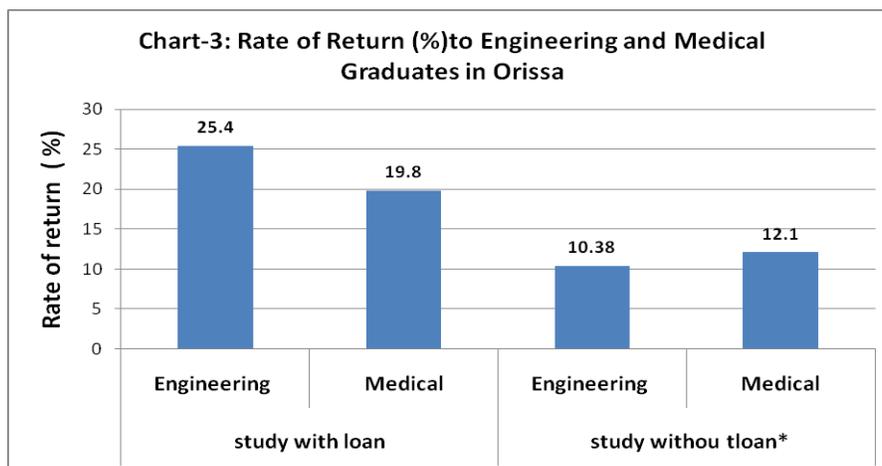
The results are presented in Table 18 and 19.



Returns to Education

From the results of the earnings function we found that the returns to engineering graduates are higher than that of medical graduates. These results are compared with the returns of education without study loan conducted by the author for the state of Orissa. Table 19 shows the comparison of the returns to education with and without loan.





It is found that the rate of return to engineering and medical graduates in Orissa with study loan is higher than the same without study loan. This provides a plea that the Banks play a significant role in influencing the earnings of the loan holders for which they incur loan. It may be on account of the reason that (i) those who complete their study without loan the cost is directly borne by the students/parents and it may be higher than the bank loan, (ii) The bank gives first priority to the merit of the students and the institutions where they continue their study. If the institution is capable to place their students in the job market with good salary package, the earnings of the students is not only higher but also it is assured with the entry of the students into the particular course. Their earning starts immediately on completion of the study. One of the conditions for loan sanction is that the institution should be of good repute.

7. Summary and Concluding Observations

Despite the significant development of higher education in India still the country is behind many developing of the countries. The enrolment in higher education has increased substantially but the proportion of students to the concerned age group of population is far behind many of the developing countries. One of the most important constraints of higher education is resource crunch particularly after the economic reforms in 1990. The country spends much less than 1 per cent of GNP on higher education and over the years this has remained either constant or declined.

Orissa being one of the educationally backward states in the country with acute poverty, face the problem of financing its education in general and higher education in particular. The state spending on higher education was 0.45 percent of the GSDP in 2000-01 and it increased to 0.60 per cent in 2009-10 which is quite insufficient to meet the challenges

of globalisation. Intra sectoral allocation of resources to education indicates that the allocation to primary education is the highest and that of higher education is the lowest. It remained less than 15 percent of the total allocated funds over the years.

The loan financing to education as an alternative source has emerged recently. It is found that Bank loan finance to students is only given to the professional courses. The social and natural sciences are not in the priority least of bank financing. The students opting for this area are not able to receive loans. Gradually the interests of the students for pursuing these branches are on a declining trend. Since merit and income of parents are the considerations by the banks for sanction of loan, the poor students with merit are likely to be deprived of this facility. Also there is no specific scheme for the backward castes in bank loan schemes. All these create inequality in access not only across education sectors but also across various groups of population. Hence the assumption that equity objective of higher education is fulfilled through loan financing to education seems to be an untenable assumption.

The sample survey findings of the study show that: (i) bank loan is directly related to income of the family and fathers occupation when it is higher income earning occupation. It indicates that the loan is not able to solve the problem of inequality in access to higher education; (ii) More than half of the loan holders are general castes and only 3 percent are scheduled castes; (iii) Across gender the loan is always found to be lower for females than their male counterparts as about 3/4th of the loan goes to male students and the rest goes to female students; (iv) The average loan amount is the highest for MBBS degree followed by M.Tech degree. The lowest amount of loan is found for the diploma course. The empirical evidence of the present study seems to confirm that bank loan does not fulfil the social objective of equity criteria of higher education.

Most interestingly it was observed that (i) the proportion of defaulters is higher when there is no collateral as the default percentage is 29 per cent without collateral and only 7 percent in case of loan with collateral; (ii) It is also a fact that better the economic status of the households, higher is the amount of default of loan. The highest amount of default is found among the service holders and the least amount of default is among the cultivators.

The return to education of the loan holders is found to be higher as compared to the return of the same education without loan. The returns to engineering and medical graduates are estimated and found to be quite high which may act as a motivational force for the students to go for bank loan in a large scale. In this context, loan financing to higher education may be considered as one of the several alternatives of higher education in the context of present fiscal stringency.

The following recommendations are suggested on the basis of the findings of the present study:

(i) Equity criteria

In order to fulfil the social objectives of equity in education, loan schemes need to be aimed at designing the scheme for the poor and needy students at lower interest rate with some amount of subsidy form the amount of the loan. Thus a discriminatory interest rate needs to be devised by the bank.

(ii) Manpower need

Loans schemes may aim specifically at providing support for students who are willing to study in fields of national manpower priority or to work in areas of social importance (doctors or teachers servicing remote rural areas). Loans schemes may either be developed specially for these groups or advantageous repayment conditions may be offered within the context of a general, non-subsidized loan programme.

(iii) Interest of state universities

In principle, loans for students enrolled in private universities, ultimately aimed at facilitating the growth of the private universities. This not only reduces the importance of state universities but also act as a de motivating force to withdraw the best students from these universities. Hence the non subsidized loans with other incentives for private universities may be sufficient to attract students to these universities.

(iv) Evaluation of the efficacy of the loan schemes

It may be suggested that there need to be some process of evaluation for the loans schemes as there can be no standard approach to evaluating the efficacy of individual loans schemes. A given student loan scheme need to be evaluated in the context of the central objective(s) that it is designed to achieve.

(v) Cross subsidisation for higher education through the loan may be encouraged by the bank.

To conclude, it may be said that the bank loans as one of the alternative sources of finance to higher education should be designed in such a way that the public spending/ subsidy on higher education need not be crowded out by the loan financing of higher education. It needs to work as supplement rather than as a substitute to government financing to higher education in the context of a less developed region characterised by wide regional/social disparities.

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