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## Government-Leading Student Loan Schemes: A Comparative Study of Hong Kong and Mainland China

Antonia Jiewei Lu <sup>\*</sup>  
Chinese University of Hong Kong, Hong Kong

Derong Chen <sup>\*\*</sup>  
No. 1 Guangfeng Senior School, China

### Abstract

Having a careful examination of government-leading student loan schemes in China and Hong Kong, we can find a lot of differences and learn something from these two counterparts which are very typical country or area faced by challenges in financing higher education in the context of transition from elitism to mass higher education. This research attempts to make a comparison of government-leading student loan schemes between Hong Kong and China in the new century. Then emphasis is put on the principles or core values namely efficiency, equity and adequacy, and determining their implications presented in student loan schemes in these two counterparts. Finally, the paper arrives at some recommendations for improvements in them.

**Keywords:** *government-leading loan scheme, Hong Kong, China, efficiency, equity, adequacy*

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<sup>\*</sup> Antonia Jiewei Lu, Chinese University of Hong Kong, Hong Kong  
E-mail: [lvjiewei521@gmail.com](mailto:lvjiewei521@gmail.com)

<sup>\*\*</sup> Derong Chen, No. 1 Guangfeng Senior School, China  
E-mail: [475590309@qq.com](mailto:475590309@qq.com)

## Introduction

Over the last half century, higher education tuition prices have been rising approximately twice or even more as fast as the rate of inflation. Anxiety over the rising cost of college education became widespread during the 1990s, in part due to the slow growth of family income relative to increases in tuition prices (Ehrenberg, 2000). It has been observed that the escalating college costs all over the world have led to direct pressure for students to seek financial aid (Cross, 1987). Students in many countries have always borrowed from family or relatives to finance either the costs of tuition or their living expenses, and many other students borrow from banks, their governments or other financial institutions (Woodhall, 1983). Besides, both developed and developing countries have witnessed the spread of the notion of education as an investment in human capital and the belief that education contributes to economic growth have encouraged many countries to improve students access to capital markets (Woodhall, 1983), therefore leading government to introduce various programs that grant financial assistance to students for educational purposes.

Three main reasons can generally explain why student loan schemes are significant: Firstly, higher education is a profitable private investment, yet many students all over the world cannot afford it out of their own or family resources; Secondly, student loans provide money when it is needed and this can be repaid in the future when the graduate is enjoying the financial benefits of higher life time earnings; Thirdly, the loan system is more equitable than an education financing system in which all costs of higher education are met from public funds, since the latter involves a transfer of income from the average taxpayer to those who are likely to enjoy higher than average incomes as a result of their higher education (Woodhall, 1983).

Countries at every level of development have important national policy priorities related to higher education (UNESCO, 2009). The major issues regarding higher education financing policy governments are facing include: who should attend college; who should pay for college education; and how to divide the appropriate contribution in financing higher education among the family, the student and the public (Frederick & Verma, 2001). In other words, to what extent should taxpayers subsidize higher education? How can higher education opportunities be equalized for disadvantaged groups like the low-income in society (Johnstone, 1986)? As such, cross-nationally comparable data are vital to formulating policies, benchmarking progress and learning from experiences in other countries (UNESCO, 2009). Based on universal consensus on the importance of higher education, different governments in different countries or areas are introducing and adopting different measures with regard to financing policy to promote its development. Among the majority of countries or areas that set high value on higher education development, China and Hong Kong are fairly representative of developing countries and developed areas in terms of government-leading student loan policies, and deserve academic scrutiny to make a comparison.

### Development of Government-Leading Student Loan Schemes in China

The tuition fee was not introduced in China until 1992 and ever since 1997, all regular higher education institutions (RHEIs)<sup>1</sup> throughout the country charged students tuition and boarding fees, which increased significantly from mid-1990s in the context of university expansion because of advocacy of mass education instead of elite education. From year 2000 to 2010, the enrolment of students in Chinese higher education has dramatically increased from around 2.21 million to 6.29 million, amounting to 23 million students in higher education (National Bureau of Statistics of China, 2010). The government nevertheless has not fully covered and funded the extra costs occurred under such expansion. Therefore, college tuition fee rises from about 2,000 RMB a year in 1997 to approximately 5,000 RMB in 2003, which has been criticized fiercely by the public and forced to remain the same level ever since.

From a macro perspective, college top-up fees were due to higher education enlarged enrolment without sufficient public resources, which resulted in several years' complaints about the ever-increasing tuition from those who are not affordable to finance it. In response to such problems, the Chinese government established a national government subsidized student loan scheme (GLSLS) for university students in 2000. After being implemented for a decade, GLSLS became the core policy and the most effective weapon for tackling financial aid needs for students in higher education.

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<sup>1</sup> Regular Higher Education Institutions in China refer to higher education institutions that do not include adult education.

## **Development of Government-Leading Student Loan Schemes in Hong Kong**

Higher education in Hong Kong underwent drastic expansion in the late 1980s, a period which saw rapid changes in its economic structure and Hong Kong shift from a basically manufacture-led to a service-led economy. That brought forth the obvious and imminent need for Hong Kong to enhance its domestic college education capacity. Tuition fees from students only made up a minimal percentage of the actual cost until the government decided to recover 18% of the university education cost through tuition in the early 1990s, therefore leading to a rapid increase in university tuition and academic expenses accompanying broadening enrolment. It was under this context of expansion and tuition hike in college that various student financial assistances for higher education such as loan schemes either progressed or were formally established at different phases.

In 1969, interest-free loans consisting of Local Student Finance Scheme (LSFS) were introduced to supplement the grant distributed to needy students based on means test which acted as a gate-keeping mechanism, while the low-interest (at a rate of 2.5% annum) loan took the place of the interest-free in 1987. In 1994, an extended loans scheme (ELS) with an interest rate of 4%, which was lower than the market rate at the time, was introduced to meet the unsatisfied needs of those students who failed marginally in the means-tested loan scheme. ELS was eventually abolished in 1998 and a new non-means-tested loan scheme (NLS) was introduced afterwards. In addition to a nominal handling fee, the NLS charges interest at a rate which flows along with the market interest rate and covers all the costs of the loan and its administration. Having gone through decades of progressive evolutions, the student loan schemes in Hong Kong have by and large developed into an elaborate system.

## **Purpose of this Study**

Having a careful examination of government-leading student loan schemes in China and Hong Kong, we can find a lot of differences and learn something from these two counterparts which are very typical country or area faced by challenges in financing higher education in the context of transition from elitism to mass higher education as predicted by Trow (1974). This paper compares the government-leading student loan schemes in Hong Kong with that in China. Then emphasis is put on the principles or core values namely efficiency, equity and adequacy, and determining their implications presented in student loan schemes in these two counterparts. Finally, the paper arrives at some recommendations for improvements in them.

## **Research Questions**

This research attempts to make a comparison of government-leading student loan schemes between Hong Kong and China in the new century. Based on data analyses, the research tries to answer questions as follows: What are the characteristics of government-leading student loan schemes in Hong Kong and China in the 21<sup>st</sup> century? What are the implications for efficiency, equity and adequacy from these two counterparts? What are the comparative advantages and disadvantages for Hong Kong and China respectively? What improvements can be made by learning from these policies? If this paper could convey one question, it would be: What are the implications and improvements for efficiency, equity and adequacy in terms of different characteristics presented in government-leading student loan schemes of Hong Kong and China in the 21<sup>st</sup> century?

## **Definition of Terms**

Higher education is an educational level that comes after the completion of secondary education such as high school or secondary school. Cost of higher education consists of the amount of tuition charged which is also referred to as price of higher education, and what students pay for higher educational services, such as living expenses and fees for books etc. Government-leading student loan scheme is a loan policy that is led and funded by the government aimed at facilitating education opportunities for college students.

## **Literature Review**

There is no consensus on the evaluation of higher education financial policy. Generally speaking, scholars tend to focus on three main principles: efficiency, equity and adequacy.

## **Efficiency**

The world has limited resources. Efficiency is the degree to which resources are used to generate the most productive outcome (Wheelan, 2010). Efficiency means that society is getting the maximum benefits from its scarce resources (Mankiw, 2008). A more efficient society can produce more with the same amount of resources (Arthur, 1975). Public policy often involves redirecting resources or changing incentives in order to achieve more efficient outcomes (Wheelan, 2010). The goal of efficiency implies that the government wants to improve the situation for one group of citizens without causing disadvantages to any other group. One of the most commonly advanced rationales for public policy and government intervention in the market is the circumstances when the market does not spontaneously reach Pareto efficiency (Weimer & Vining, 2011).

## **Equity**

A concern for equity has long been an important aspect of economic analysis, as Adam Smith claimed “No society can surely be flourishing and happy, of which the greater part of the members are poor and miserable. It is but equity, besides, that they who feed, clothe and lodge the whole body of the people, should have such a share of the produce of their own labor as to be themselves tolerably well fed, clothed, and lodged” (Smith, 1976, p88). Equity refers to fairness and social justice as opposed to equality which refers to sameness (Gilbert & Terrell, 2002). It enables every citizen to become an official member of the society (Short, 2002). Fairness or justice denies that the loss of freedom for some is made right by the greater good shared by others (Rawls, 1971). Justice as fairness should be made to maximize freedom and opportunity for each individual within society, and to provide in some common way for its least advantaged members (Wheeler, & Kearney, 1996).

## **Adequacy**

The primary purpose of any student loan is to defer fees (including both tuition and maintenance) in order to make higher education free at the time of use (Barr, 1998, 2002, 2003; Johnstone, 2003a). In any event, the adequacy of benefits is an important factor for consideration of any policy change (Wheeler, & Kearney, 1996). However, the level of adequacy is not easy to define; it is difficult to distinguish between genuine basic needs, luxury needs and needs in disguise (Chung, 2003).

## **Methodology**

### **Measurement**

Based on literature review, several measurements and items are chosen to respectively demonstrate different principles and implications in the two different student loan schemes.

*Efficiency.* In a world with a finite quantity of resources to support the development of higher education, allocations must be rationed in one way or another. Public policy aims to be efficient, thereby putting society’s resources to the most productive use (Wheelan, 2010). The items that this paper use to measure efficiency of GLSLS in China and LSFS, NLS in Hong Kong are listed as follows:

- (1) Non-payment rate. It calculates the default rate of student loan offered, which is an important factor of running efficiency of the schemes.
- (2) Administration cost. The total cost of running such schemes is directly related to efficiency.

*Equity.* There is a social goal of equalization in the provision of education in most modern societies; the purpose of student financial assistance systems is to ensure that no student is denied in a university education because of a lack of means (Chung, 2003). Several items are adopted to measure the equity value of these two systems:

- (1) Target group. Who can benefit from the schemes is an important criterion of equity.
- (2) Extent of benefit. To what extent the students can benefit and how to allocate loans according to different needs and among different groups also implicate something important about equity.
- (3) Screening criteria. It is used to decide who is eligible and can be offered the loan, thus affect equity directly.

*Adequacy.* We could look at adequacy from two perspectives: the extent to which they would provide students with a benefit that meets their genuine basic needs, and the degree of burden the loan may impose on these students in terms of repayment. The following items are chosen to demonstrate it:

- (1) Interest rate. If interest rate is high, then the student may not apply for loan because of cost consideration. Also, high interest rate will impose heavy repayment burden on students.
- (2) Coverage. What the loans will cover --tuition, academic expenses or living expenses— decides

- how the student can benefit from the loan.
- (3) Repayment time. Short and inflexible repayment period influence student by placing burden on the life after students graduate.

Table 1. Measurements and items of Government-leading student loan schemes

efficiency	Non-payment rate, administration cost
equity	Target group, extent of benefit, screening criteria
adequacy	Interest rate, coverage, repayment time

### Data Collection

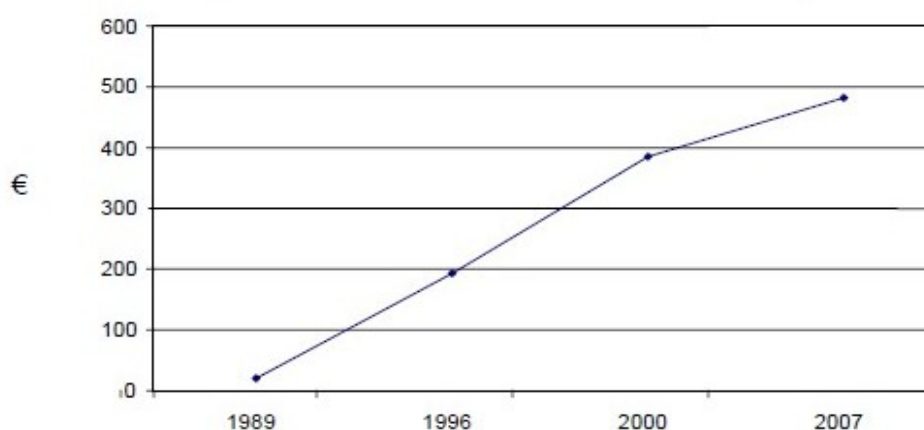
Archival data and statistics are collected from the websites of China National Center for Student Assistance Administration (CNCSAA), Hong Kong Student Financial Assistance Agency (HKSFAA), and United Nations Educational, Scientific, and Cultural Organization (UNESCO) etc. to analyze characteristics of government-leading student loan schemes in Hong Kong and China. Besides that, the researcher has done some preliminary survey regarding student living expenses etc. in Nankai University, which is a typical regular higher education institution.

### Characteristics in China Government-Leading Student Loan Scheme

*Limited target group.* The leading disadvantage of GLSLS lies in profit-driven banks acting as administrative bodies for student loans. Whether to grant a loan under GLSLS are decided by commercial banks largely on the basis of one's ability to repay instead of genuine need. Consequently, student loans might be offered to students not in need but from prestigious institutions, while leaving those in lower tier such as vocational training institutions, struggling to obtain a student loan. Oversupply in high-ranking institutions and insufficient amount divided among lower tier institutions, from an economic approach of higher education financial policy, is a representative case of free market failure.

*Ambiguous screening criteria.* Those who are poor and apply for GLSLS loan are required to submit s from the local Department of Civil Affairs. However, when it comes to who will receive the loans, no clearly stated criteria such as family income level are stated in the official documents of GLSLS in China.

*Limited coverage.* According to a survey carried out by the China Youth Daily and another report from China Weekly Reading, fees officially jumped from 200 RMB (18 €) per year in 1989 to some 5,000 RMB (450 €) nowadays (See Figure 1: Tang, 2001; Guo, 2007). The amount of loan a student receives can only cover tuition following this trend.



Source: Tang, 2001; Guo, 2007.

Figure 1: Development of Higher Education Tuition Fee in China (1989-2007)

However, besides tuition fee hike, the living expenses of a typical college student have also undergone the similar trend (See Table 2). This implicates that the student loan is not enough to take these tendencies into consideration and to some extent improve the basic living needs of a poor and needy college student-the coverage is so limited.

Table 2. General Living Expenses Level of College Students  
(Example of Nankai University, China)

Pay (RMB per month)	Percent
Under 300	4.76%
300-500	14.28%
500-800	29.52%
800-1000	23.81%
1000-1500	19.05%
Above 1500	3.81%

Source: A Survey of College Students' Living Expenses, 2011, done by the researcher.

*Short and inflexible repayment time.* According to a research study conducted by Shen & Li (2003), students who are required to pay off their loans within four years after graduation have to set apart on average a quarter of their annual income for repayments. Since 2008, the policy has changed and allows students to pay the proportional amount of income and fluctuate with their income ability, but the student still has to pay off within 6 years of graduation. Such a proportion of earnings required as repayment is simply so much and the six-year duration so short that it could bring about debt aversion for new recipients and stop them from considering student loans as an option to meet their financial assistance need.

*Serious sanction for default.* Under the GLSLS, the students who fail to repay will get punishment in the way either their names will be published in the media or they will have adverse credit history that will be an obstacle for future private loans, which only harms one's reputation but cannot ensure one to repay. Terms such as "fully repay in four years after finding a job", "names published in the media for those failing to repay" without taking whether one's income is high enough to repay etc into consideration, are what those who borrow a student loan have to face. They to a large extent threaten students to take the scheme as a resort for educational poverty.

Table 3. Features of government-leading student loan scheme in China

Implementation year	2000
Target group	Poor full-time students in regular higher education institutions (REHI)
Interest rate	Fully subsidized before graduation, 50% subsidized afterwards (before the year 2004); full subsidized before graduation, a rate based on rate policies made by central bank after graduation (after the year 2004)
Grant size	6,000 RMB
Coverage	Tuition fee for undergraduates; living expenses for postgraduates
Repayment time	4 years after graduation (before the year 2004); 6 years after graduation (after the year 2004)
Repayment way	Monthly installments
Guarantor	Student credit
Sanction	Publish defaulter's name in the media; adverse credit history and prevention from additional bank loan for living or investment in the following one or two decades.
Screening criteria	Not clearly stated
Administrative body	Commercial banks

Data source: China National Center for Student Assistance Administration. <http://www.xszz.cce.edu.cn>, 2011.

### Characteristics in Hong Kong Government-Leading Student Loan Scheme

The student loans scheme in Hong Kong has evolved from completely free of interest to low interest to its present state, including loans at the interest-bearing market rate. In total, this system is relatively elaborate and has many characteristics.

*Wide target group and coverage.* LSFS is mainly aimed at needy full-time students in Publicly-Funded Programs (PFP), while students whose financial needs for educational purposes are not covered in LSFS can turn to NLS for tuition fees or sometimes living expenses. Besides the scholarship and grants that can cover tuition fees for needy students, the loans aimed at purposes outside tuition are to some extent enough to cover their basic needs. This is mainly because of the application of a Student Expenditure Survey in the estimation of maximum grants and loans to a student, which gives a fairly accurate estimate of what a student would actually need in order to survive (Chung, 2003). The tables as follows show the percentage of loan approval (No. of applicants with loan offered divided by No. of applications received) and amount of loan offered. The loan approval rate in LSFS for the academic year 2009/2010 is 88.6% and 89.3% for 2010/2011, while NLS almost grant loans to every applicant. All of the information has pointed out the wide target group and coverage of government-leading student loan schemes in Hong Kong.

Table 4. Statistics of Student Loan Under LSFS

Academic Year	2009/2010	2010/2011 (as at 31.10.2011)
No. of eligible students	82,921	81,975
No. of applications received	31,932	31,185
No. of applicants with loan offered	28,290	27,869
Average amount paid	\$25,101	\$25,594
Total amount of loan offered	\$728.40m	\$725.07m

Data source: Hong Kong Student Financial Assistance Agency. <http://www.info.gov.hk/sfaa>, 2011.

Table 5. Statistics of Student Loan Under NLS

Academic Year	2009/2010	2010/2011 (as at 31.10.2011)
No. of applications received	34,402	34,143
No. of applicants with loan offered	34,071	33,749
Average amount paid	\$45,831	\$46,480
Total amount of loan paid	\$1,222.3m	\$1,228.8m

Data source: Hong Kong Student Financial Assistance Agency. <http://www.info.gov.hk/sfaa>, 2011.

*Clear screening criteria.* For LSFS, the level of loan is determined by a clear two-tier means test. First, compare your Adjusted Family Income (AFI) against the "Ready Reckoner" to get the first percentage of loan, then apply this percentage to calculate the living expenses loan (HKSFAA, 2011). Second, compare the Net Asset Value of your family against the "Sliding Scale of Asset Value for Discounting Financial Assistance" to get the first percentage of loan, then adjust the level of loan calculated by the discount factor to get your final level of loan (HKSFAA, 2011). After this test, the scheme will sort out who can actually get the loans, which is a fairly useful tool to differentiate between the needy groups.

*Long repayment time.* Under LSFS, students are required to repay by 20 quarterly installments 5 years after graduation or ceasing to be a student of the institution, while those who get a loan from NLS have 10 years after completion of the relevant course. Both of them have taken the students' ability to repay into account: the students who can get a loan from LSFS are those who study at PFP and who have generally better jobs and higher income after graduation, while those who borrow money under NLS have a higher burden of repayment because of a higher interest rate and thus a reasonable extension of repayment time can ease them and activate their willingness to repay in time.

*Relatively temper sanction for default and increasing default rate.* Compared to China's humiliating sanction, Hong Kong government take relatively temper punishment measures for delayed repayment or default, which is criticized as an impetus for increasing default rate in the recent years and a harm to taxpayers who are actually bearing the burdens for the immoral behaviors of those students.

Table 6. Features of government-leading student loan scheme in Hong Kong

	LSFS	NLS
Implementation year	1960s	1998
Target group	Needy full-time students in Publicly-funded Programs (PFP)	Students whose needs are not met in the LSFS
Grant size	Depend on individual average disposable family income and per capita family asset; maximum amount of loan of the 2011/12 academic year is \$37,960	Maximum loan is capped at the maximum amount of tuition fees payable
Interest rate	From no interest to a rate of 2.5%	A rate covering all the costs of loan and administration
Coverage	Living expenses	Tuition fees and sometimes living expenses
Repayment time	5 years after graduation or ceasing to be a student of the institution	10 years after completion of the relevant course
Repayment way	20 quarterly installments	40 equal quarterly installments
Guarantor	Student credit	
Sanction	Surcharge of 5% on the quarterly installment; serious or prolonged default are referred to the Department of Justice for legal recovery action	Repayment amount including interest in arrears is charged at prime rate; serious or prolonged default are referred to the Department of Justice for legal recovery action
Screening criteria	Two-tier means test on Adjusted Family Income (AFI) and Net Asset Value of the family (NAV)	None
Administrative body	Hong Kong Student Financial Assistance Agency	

Data source: Hong Kong Student Financial Assistance Agency. <http://www.info.gov.hk/sfaa>, 2011.

## Conclusions and recommendations

### Government-Leading Student Loan Policy Learning for China

*Balance different groups and needs.* Obviously Chinese higher education finance policies are lopsided to prestigious universities and REHIs. While this is important for China to face international challenges from peer universities, it is also significant to dedicate more resources to those non-regular higher education institutions and lower-rank universities, which may be a strategic adoption to improve the whole higher education quality in China.

*Clarify screening criteria.* The GLSLS should establish clear criteria, such as family income, net asset value of the family and regional living expenses for a typical RHEI student, to better test and estimate the real basic needs of the student. Comprehensive survey of the necessary data is important.

*Adjust repayment time.* For example, the current loan repayment period should be extended. Also, repayment requirements should be flexible giving some reasonable consideration to the borrowers' affordability to repay. To get better repayment results, deferring starting point of loan repayment or beginning repayment only on securing employment would be a proper choice.

*Broaden coverage.* The grant from GLSLS is obviously so mean that it only covers tuition fees at average level. Coverage extended to both tuition and maintenance is one of the core features in the HK student loan scheme and should be taken into account in the next reform of student loan policy in China.

*Incrementally abolish humiliating sanction and cultivate a credit culture.* Under the scheme, students who do not repay their loan before graduation could not receive their certificates. Reserving a diploma would not help to enhance the situation as students in debt will find it difficult to get a job without the relevant certificates. Literature related to student loans in China usually argues that government should do more to cultivate a credit culture among college students given the fact that credit banking has been established only for a few years in China (Shen & Li, 2003). It would be more human as well as effective if the government cultivate such culture and in the meantime dedicate to abolish humiliating sanctions incrementally.



### **Government-Leading Student Loan Policy Learning for Hong Kong**

*Require credit report from mature loan borrowers.* To lower default risk, it is advisable to require mature borrowers (e.g. over 30 years old) applying for student loans the first time above a certain amount (e.g. over \$100,000) pertaining to a particular course to offer a personal credit report from some credit reference agency. This could enable SFAA to decide whether a loan may be supplied in part or in full to the student concerned based on one's credit history in accordance with a series of prescribed criteria.

*Improve usefulness and sustainability.* Continuous financial resources from the government should be provided to keep the scheme viable. It will be better for the NLS to become self-sustaining through better design as the loan costs and the default risk are regarded as factors in setting the interest rate. However, to what extent are student loans scheme useful and sustainable relies not just on the design of the schemes. To ensure the loan to be more useful, the NLS loan should reach all the needy students and also those who are willing to take up the offer for investment in higher education. In other words, the loans should cover the targeted groups for the targeted purpose. To ensure the loan to be more sustainable, repayment needs to be guaranteed and total repayment must arrive at the level of initial loan payment for the present year to make the ends meet.

*Room for participation of commercial banks.* There is room for commercial banks to participate in the student loans scheme. The Financial Secretary of the Hong Kong government positioned himself as a "proactive market facilitator" in his Budget Report 2002. It will be important for the government to make out the costs and benefits of various facilitating measures, such as subsidizing interest and using indemnifier, for the student loans market. Including commercial banks in the interest-bearing student loans scheme is advisable, whereas it should avoid the situation China has underwent. That is, who to grant the loan should not be decided by profit-driven commercial banks. They can take part in relevant activities such as releasing loans, taking in repayments and provide auxiliary service to the loans scheme.

### **Concluding Remarks**

There is high efficiency in the mobilization of the loan funds in Hong Kong due to the effectiveness of the SFAA and the small geographic area that it has to cover (Chung, 2003). LSFS and NLS together provide comprehensive loans to local student and ensure equity and efficiency. The wide coverage and adequate grant size in these two schemes enable students to have adequate financial support for their educational purposes. From all these aspects, China fall short and should learn from Hong Kong by initiating reform incrementally. To meet increasing challenges facing higher education, more strategic government-leading student loan policies should be developed both in Hong Kong and China. These reforms should be designed to increase efficiency, improve equity, and raise overall adequacy of student loan, as well as achieving greater conformance with the UNESCO goals.

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