

EABER WORKING PAPER SERIES

PAPER No.43

CHINESE EDUCATION FINANCE: ISSUES AND CHALLENGES

WANG RONG, WEI JIANGUO, YANG PO, AND YI QIAN
PEKING UNIVERSITY

PAPER PREPARED FOR DISCUSSION AT THE
*DPU/EABER CONFERENCE ON FINANCING HIGHER EDUCATION AND ECONOMIC DEVELOPMENT IN
EAST ASIA*
BANGKOK 16 – 17 JULY 2008

EABER SECRETARIAT
CRAWFORD SCHOOL OF ECONOMICS AND GOVERNMENT
ANU COLLEGE OF ASIA AND THE PACIFIC
THE AUSTRALIAN NATIONAL UNIVERSITY
CANBERRA ACT 0200 AUSTRALIA

Chinese Higher Education Finance: Issues and Challenges

WANG Rong, WEI Jianguo, YANG Po, Yi Qian

Peking University, P.R. China

Part III. Financial Aid for College Students in China

Equal distribution of higher education opportunity does not come along naturally with the rapid higher education expansion in China. This is particularly true for the distribution of high quality higher education resources. The socioeconomic stratification among students from different HEIs becomes increasingly explicit, implying that students from low SES background increasingly tend to concentrate in low quality institutions. At the meantime, the priorities of governmental financial support focus predominantly on elite central colleges and universities. Thus it leaves relatively little support for locally owned higher education institutions who serve the majority of low SES students. Hence, it is critical to set up a student aid system to accommodate the needs of those disadvantaged students. In the past several years, Chinese government initiated several higher education financial aid schemes with some successes and failures. The following discussion is based on the current higher education financial aid scheme in China, reflecting on their achievements, issues and challenges.

1. Historical Development of Chinese Higher Education Financial Aid System

Parallel to the rapid expansion of Chinese higher education system and the introduction of cost-sharing policy in higher education sector, Chinese student financial aid system grows up gradually in the past several years. Since 1997, all higher education institutions in China adopted a single-track admission system which

required all freshmen to pay similar tuition and fees, replacing the old two-track system which charged differentiated tuition and fees depending on student enrollment status¹. Most HEIs also implemented a new cost-sharing policy. College tuition and fees became an increasingly heavy burden for rural and urban households. In order to ensure students from low SES households can complete their college education, Chinese government invested intensively in the construction of college student aid system. Traditionally, HEIs financed students by introduction of People Scholarship and tuition waiver. At present, Chinese colleges and universities develop a comprehensive financial aid system which includes grant, scholarship, student loan, work-study, tuition waiver, tuition reduction, subsidies for needy students and opening "Fast Service Center" for student aids. This new financial aid system experiences constant adjustment and enrichment, and it is still under development up to now. Its development can be divided into four stages:

Phase 1. Before The 1999 Expansion

Before the grand expansion of higher education sector in 1999, Chinese government supported its students through tuition waiver and introduction of People Scholarship. Since 1987, People Scholarship evolved into student grants and loans programs. Student loan was a kind of interest-free government loan for in-school students. It was administrated and collected by HEIs.² Government gradually implemented other financial aid policies, such as subsidy for needy student in 1993, work-study program in 1994 and tuition reduction or waiver in 1995.

Phase 2. From 1999 to 2003

The grand expansion stimulated the development of student financial aid system. Since September 1, 1999, every HEI must allocate 10% of its tuition revenue to

¹ Two-track system charged no tuition and fees for students in the quota system and high tuition and fees for students who were not admitted by the quota system. The latter group was treated as fee-paying students.

² This interest-free government loan was also called institutional interest-free loan, which differs from student loan program mentioned in the latter part of this paper.

support its work-study program, in order to improve compensation standard for work-study students and enhance financial assistance for needy students. Centrally administered HEIs in eight cities adopted a pilot National Student Loan Program in 1999 through local Industrial and Commercial Bank of China (ICBC). Central government subsidized the program by paying loan interest through fiscal appropriation. In 2000 the pilot extended to a nationwide program, and the other banks joined ICBC to provide National Student Loan, such as Agricultural Bank of China, Bank of China and China Construction Bank. National Student Loan Program was started fully and it was subsidized by levels of financial departments and targeted at locally administered HEIs. The student loan business was consigned to certain banks. Meanwhile, some provinces began to provide Rural Credit Cooperative Loan from agency in student hometown region.

To guarantee low-income students could matriculate into college smoothly once they were admitted, Ministry of education, ex-Central Planning Commission and Ministry of Finance jointly mandated HEIs to build up a "Fast Service Center" program in 2000, which allowed admitted students from low-income families to enroll in college first without paying tuition. Once HEIs verified their household financial status, colleges and universities provided them with appropriate financial aid packages.

Chinese government initiated National Fellowship Program in 2002. Central government intended to support low-income and academically excellent students with such grant. National Fellowship is graded into two levels and covers 45,000 students per year. The first-class award is \$860 per year and 10,000 students are rewarded by the first-class grant. The second-class award is \$570 per year and 35,000 students receive it. In addition, all fellowship winners also are offered tuition waiver for that year. Provincial and other local governments set up earmarked funds to finance such government-sponsored fellowship program.

Phase 3: From 2004 to 2006

The National Student Loan Program was challenged in 2003. Most commercial banks were reluctant to distribute student loans because of the large number of individual loan service to provide, small amount of loan payment per service, high maintenance cost and relatively high risk of default. Hence, the distribution of National Student Loan program was to halt in 2003. In order to promote the development of student loan program, Ministry of Education, Ministry of Finance, People's Bank of China, and China Banking Regulatory Commission mandated a new policy for student loan program (*Several Opinions on Further Improving the Work on the State-subsidized Students Loan*) in June 2004. The new policy made adjustment for the student loan program and had some impact upon banks' practice. According to 2006 data by Ministry of Education, the banking industry had approved loan credits for student loan program closed to \$2.44 billion since 1999, which covered 24.1 million students. From 2004 to June 2006, the banking industry loan credits closed to \$1.6 billion which covered 15.4 million students. During this time period, China Development Bank started to offer student loans in some provinces.

In 2005, Chinese government reformed its National Fellowship Program and converted it into a National Scholarship Program. The new program had two parts. (1) The National Fellowship program targeted at needy and capable student who enrolled full-time at four-year institutions. About 50,000 students were eligible for the Fellowship per year and each would receive \$493. (2) The National Grant Program intended to support full-time students from extremely poor families. The Grant would cover their living expenses with \$21 per month and ten months per year. The Grant program would cover 0.53 million students per year. Provincial and other local governments were mandated to set up earmarked funds to finance such government-sponsored grant program.

Phase 4: From 2007 to date

The State Council implemented another new policy for student financial aid in 2007 (*Opinions on Establishing and Improving the Policies for Subsidizing Students in Universities of Regular Undergraduate Education, Post-secondary Vocational Schools and Secondary Vocational Schools from Families with Financial Difficulties*). The new policy made significant changes for current student aid system, which was the largest adjustment since 1999. The financial aid policy required government should allocate \$7.1 billion earmarked fund annually for student financial aid (including aid for students in vocational middle schools) since this Fall of 2008. The earmarked fund should include government budgetary appropriation, student loan and institutional aid. It is worthy of mentioning that the amount of central government aid for National Scholarship Program in 2006 was only about 0.26 billion, while local government support for student aid was also very limited. The situation for the first six months in 2007 was slightly better, and the total government input for student aid was equal to \$2.2 billion. Once the new financial aid system is established, the government investment for financial aid in year 2008 will be around \$4.4 billion. Four million college students from 1,800 HEIs will benefit from the new program.³

The aforementioned new policy will mainly regulate the following areas: (1) enhancing the National Fellowship Program. Central government will continue to support National Fellowship program, in order to award excellent students from four-year institutions and vocational higher education institutions. The coverage will be 50,000 per year and each student will received \$1,150 per year. Central government is the sole provider of the fund. The grant will no longer focus on need students. It will change to a merit-aid program with a single goal of rewarding the most capable students. (2) Central and local government will co-sponsor the National Incentive Fellowship, which will reward academically acclaimed students from low-income households. The amount of the Fellowship will be equal to National Fellowship (\$710 per year) and 3% of total college student population will receive

³ http://www.gov.cn/jrzq/2007-09/09/content_743590.htm (2008-6-23).

such aid. (3) Enhancing the National Grant program. Central and local government will co-sponsor the National Grant program, which provides financial aid for needy students who enrolled in academic or vocational higher education institutions. The program covers 20% of total college enrollment. The average aid amount is about \$285 per year. (4) Teacher education students who enrolled in normal universities affiliated to Ministry of Education will receive tuition waiver, accommodation fees and living cost subsidies. (5) China Development Bank loan from agency in household region will be piloted in Jiangsu, Hubei, Chongqing, Shannxi, Gansu and other provinces. (6) The student aid system will extend to private higher education institutions. Meanwhile, HEIs have to commit to allocation 4-6% of their recurrent revenue to tuition reduction or waiver, work-study, risk compensation for national student loan program, institutional interest-free loan, institutional grant, and subsidy for needy student programs.

2. Four Patterns of Chinese Student Loans Program

Some recent surveys of higher education institutions in 2006 and 2007 showed that the 2007 adjustment of student aid policy had significant impact on students and institutions. The enlargement of the distribution of national grant program had solved the fundamental difficulty facing HEIs in dealing with student aid issues. However, the Grant program is designed to meet student need to cover living expenses. College students have desperate needs for student loan to cover their tuition and room and board expenditures, which are much higher than their living expenses. Student loan scheme is an effective financial instrument to deal with cost-sharing in higher education internationally. Currently, China adopts four different kinds of student loan schemes.

2.1. Type 1: Commercial bank loan from agency in university region

Commercial bank loan from agency in university region is also referred to as the National Student Loan Program. However, the fund is not provided by central

government. Student loan covered by this program is provided by commercial banks in regions where students enrolled as full-time students. Colleges and universities facilitate commercial banks to distribute loans, to manage loan service and collect repayment. Government and HEIs share the risk compensation fund for commercial banks (50% each). Undergraduates from public four-year institutions or vocational higher education institutions, students with double majors and graduate students are all eligible for the Program. The maximum loan credit is \$860 per year. Government subsidizes the loan interest when students are enrolling full-time in school, while college graduates are responsible to pay the loan interest in full. For students who signed the loan contract before August 2004, they were required to pay 50% of their total loan interest. The other half were paid all by government. According to college graduates' employment and income, they can choose the timing of their loan repayment period, which has to begin within two years after graduation. The full amount of loan and its interest have to be paid back within 6 years. For students who signed the loan contract before August 2004, they were required to pay back their total loan and interest within four years.

2. 2. Type 2: Rural Credit Cooperative loan from agency in household region

This type of student loan is offered by rural credit cooperative located in student's household region. Zhejiang Province initiated this loan program in July 2001 as a pilot. State Council legalized this type of student loan program in 2004 by publishing a new policy brief (*Several Opinions on Further Improving the Work on the State-subsidized Students Loan*). Many provinces have adopted this new loan program, such as Xinjiang, Jiangsu, Guizhou, Yunnan, Gansu, Shandong, Jiangxi etc. Since this type of loan program is developed by local government, there is no standardized approach. Different regions have various approaches to provide their student loans. At the very beginning, there was no requirement for risk compensation fund. After policy change in 2004, rural credit cooperatives which ran such programs were eligible for risk compensation fund. Government subsidies for student interest payment when

they are in school. The maximum loan credit is also \$860 annually and the repayment period is within six years after college graduation. The major advantage of this program is identification of household SES status and loan collection. Since rural credit cooperatives have branches and personnel in rural areas and are close to parent households, they are easier to get information about student household and their income.

2. 3. Type 3: China Development Bank loan from agency in university region

This type of student loan is provided by China Development Bank (CDB) in regions where students enroll as full-time students. This is also referred to as CDB model or Henan model, named after the Province where the program was initiated. Henan Province collaborated with China Development Bank to jointly offer national student loan program since December 2004. From 2005 to 2007, Henan Province provided \$0.24 billion student loans for 0.35 million low-income students, which ranked number one in the nation. This model was adopted by other provinces in a short time period, such as Qinghai, Shanxi, Inner Mongolia, Guangdong, Hunan etc. The major characteristics of this model include: (1) risk sharing and compensation. The risk compensation fund is shared by government and HEIs. CDB in the province manages the risk compensation fund under a special bank account. (2) Student loan management center at provincial level serves as management and information platform for student loan program, which is the agency linking CDB at provincial level and HEIs. (3) Student aid centers in higher education institutions manage the daily operation of national student loan programs. Their responsibilities include receiving loan application, signing loan contract, distributing fund, collecting interest and information system maintenance. (4) The maximum loan credit is \$860 per year. The interest is paid by government before graduation and by students after graduation. College graduates should repay their loans in one installment within six years after graduation. But they can pay back the loan interest in many installments.

2. 4. Type 4: China Development Bank loan from agency in household region

This loan program is the combination of the Type 2 and Type 3 loan programs. CDB at provincial level offers student loans for college students whose households are in the same province. This new loan program was part of the 2007 policy brief and taken as a major policy adjustment since then. The program had served 0.11 million students by Dec 17, 2007 and offered \$0.19 billion student loans. The major traits of this program include: (1) College freshmen and continued students who enrolled in accredited public four-year institutions, vocational higher education institutions and private institutions and independent colleges. (2) The program established county-level student aid management centers in catchment areas, in order to receive loan application, conducting preliminary review of student application and collecting loans on behalf of CDB. (3) The maximum loan is \$860 per year. The repayment period equals to years of college enrollment plus ten years, but less than 14 years. (4) The interest payment has to be made annually. Government pays the interest before graduation and students and their families pay the interest after graduation. College graduates pay back the loan in several installments. (5) The program requires setting up risk compensation fund, which equals to 15% of total amount of student loan.

3. Issues and Challenges for Chinese Student Loan Programs

Although currently all four types of student loan programs are adopted and operating, there is no dominant pattern with explicit advantage. Nationwide, student loan as an important part of student aid system has not functioned to its full capacity. There are also many challenges in the implementation of student loan programs.

The coverage of student loan program cannot fully satisfy student demand. According to unpublished data collected by MOE, there is unmet student need measured by the gap between loan application and approved loan application since the adjustment of student loan policy in 2004. Table 1 describes the recent trend in student loan

coverage (proportion of students whose needs are satisfied by student loan program). Student loan coverage varies cross time. For instance, the coverage rate increased from 2.7% in 2004 to 6.6% in 2006 and dropped to 4.6% in 2006. Prior studies reveal that 20% of Chinese college students come from low-income families.⁴ A recent survey of student loan program (Type 4 loan) in one province showed that there was large variation in loan coverage. In most counties within the province, student loan coverage was less than 25%. Although student grant can satisfy student's need for living expenses, college students still need the support from student loan program to pay for their tuition and room and board. A significant proportion is currently left behind from loan programs.

Table 1. Coverage of student loan program for needy students (2004-2006)(Unit: 0.1 Billion RMB)

	2004	2005	2006
Total enrollment (Unit:10,000 students)	1350	1387	1849
Loan applicants (Unit:10,000 students)	70.32	118.31	190.00
Approved applicants (Unit:10,000 students)	36.73	91.61	85.50
Loan coverage	2.72%	6.60%	4.62%

Source: MOE statistics on college student financial aid programs 2004-2006 (unpublished).

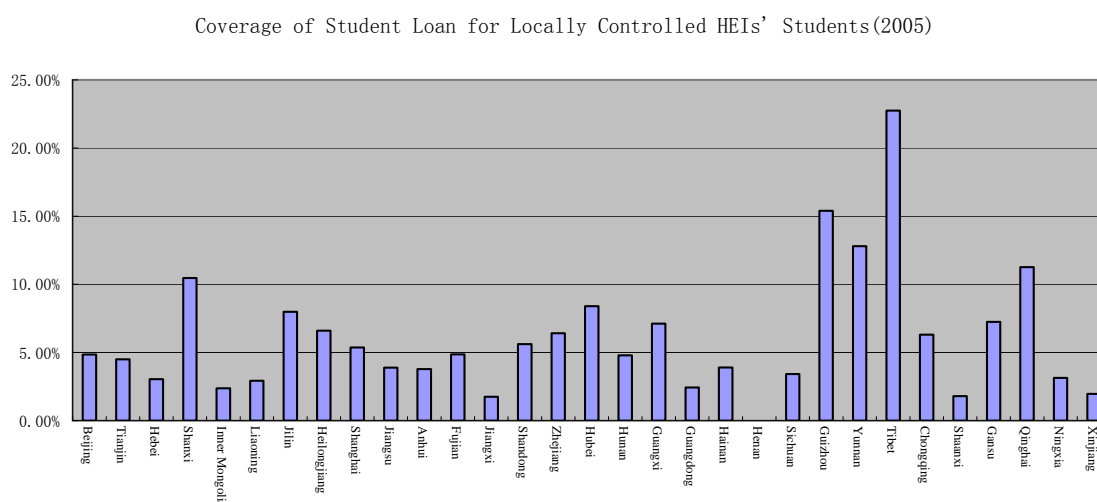
There is a lack of balance in student access to student loan by institution type. Central controlled institutions perform better than locally controlled HEIs. In other words, there is a higher proportion of students from central HEIs received student loans than their counterparts enrolled in local owned institutions. For instance, the loan coverage was 9% for HEIs affiliated to MOE in 2004, 7% for HEIs affiliated to other ministries, and 1.6% for locally controlled institutions, as indicated by Table 2. The proportion changed in 2005; however, the situation was still favor central institutions. Table 3 reports that about 7% to 8% of students from central institutions received financial assistance from loan programs, compared with 6.5% of college students from local institutions. There is another disparity among locally controlled institutions. In

⁴ <http://www.moe.edu.cn/edoas/website18/32/info29832.htm> (2008—6—29) .

general, vocational higher education institutions perform even worse than general public four-year institutions. They are least favored by the current system.

There is also large variation among regions in terms of loan coverage. For instance, the loan coverage rate varied from 1.8% to 22.8%. (See Chart 1)

Chart 1.



Source: MOE statistics on college student financial aid programs 2005(unpublished).

It is hard to identify household economic status. Since individual income tax is not the major tax category in China, the taxpayer coverage is very limited right now. It is not possible to rely on income tax levy system to collect information on household economic status. However, all four types of student loan programs running in China depend on, to some extent, identification of household income in loan application. The requirement for household income identification varies across loan programs. For instance, Type 1 commercial bank loan has rather rigid requirement. In contrast, Type 3 and Type 4 loan programs by China Development Bank have relatively loose requirement for income identification, follow the principle “those who are eligible should be covered by loan program”. At present, the major method of income identification is to ask loan applicants to provide various income-related documents. These documents are easy to obtain and have relatively little discriminative power.

Hence it is a waste of social resource and reduces the power of income identification. In addition, some low-income families have limited social network. They can hardly obtain all the necessary documents for student loan application and are therefore denied their rights to student loan, which creates new inequity in society.

The risk sharing mechanism is not well established. Chinese government is not sharing the risk of student loan program and taking in charge of such program by providing loan guarantee. Risk compensation fund is the major instrument for risk sharing in China, which was introduced by commercial banks in 2004 and was copied by other loan programs thereafter. By definition, the risk compensation fund equals to certain percentage of total student loan credits approved by banks. In practice, there is variation in terms of program design. Type 1 and Type 3 loan program required government and higher education institutions to equally share the burden of risk compensation fund. Type 2 loan program has no uniformed requirement. In some provinces, the requirement is same as Type 1 loan. But in other provinces, rural credit cooperatives can only receive half of their risk compensation fund paid by local government. Type 4 loan program required government to pay the total amount of risk compensation fund, which equals to 15% of total loan credit amount. There is no uniformed standard for the size of risk compensation fund for other types of student loan program.

There are several issues of concern regarding the risk compensation fund. (1) Under the current design, the loan coverage within a university influences the amount of risk compensation fund paid by this institution. Hence, there may contribute to further disparity in loan coverage cross institutions. The more serious question is whether it is reasonable to mandate HEIs to pay risk compensation fund? (2) Central government pays the risk compensation funds for centrally controlled HEIs when they involve in student loan programs, while local governments share risk compensation fund for locally controlled HEIs with student loan burden. In general, there is large variation in

fiscal capacity of local governments, which will lead to explicit difference in financial burden in terms of payment for risk compensation fund. Moreover, banks charged even higher rates for risk compensation funds in economically poor regions with weak fiscal capacity. (3) Under Type 1 and Type 2 loan programs, risk compensation fund works as current period income for financial institutions. Under every circumstance, banks can collect fixed proportion of risk compensation fund. Hence, it is not possible to solve the risk control issue in the future or give right incentive for financial institutions. Under Type 3 and Type 4 loan programs, risk compensation fund is not treating as income for current period, and its final calculation depends on the effectiveness in loan collection. There is inherent incentive mechanism; however, the incentive chain is way too long to be effective, since the final calculation only happens when the repayment period is over. During the repayment period, there will be personnel adjustment but no effective mechanism to produce sufficient incentive. In addition, this institutional arrangement postpones the financial risk to the later period. When the risk realizes itself, it will impose big threat for the financial institutions.

There are shortcomings in loan collection. The personal credit system by People's Bank of China was recently established, which had not fully functioned during student loan collection period. In addition, there is insufficient consideration for special conditions of loan applicants during the repayment period, such as unemployment, extremely low income, serious illness and unintended incidents. As for the length of repayment period, most programs set their collection period as six years, except for Type 4 loan program. Six years are too short for loan repayment and will create big burden for loan applicants, which is not beneficial for loan collection.

Competition among different kinds of student loan programs. Four types of student loan programs have various aforementioned deficiencies. Type 1 commercial loan has longest history; however, its future is not optimistic. Suspension of this program in

certain regions, in conjunction with many years of unsuccessful experience shows that commercial banks are reluctant to participate in student loan programs. Although government uses loan interest subsidy and risk compensation fund as incentives, student loan programs are not interesting for large financial institutions in terms of market attractiveness. It is possible to consider alternatives such as the distribution of small amount loans, using the concept of social responsible investment. In other word, some provinces should pilot to open student loan companies and allow these companies to substitute commercial banks in Type 1 loan program. It is possible to increase the effectiveness of student loan program through the professional service of such companies.

As for the rural credit cooperative model (Type 2), it is possible to use Type 2 loan program as supplement for Type 1 and Type 4 loan schemes in regions where rural credit cooperative are relatively strong. As for Type 3 loan program, it enjoys the advantage in loan distribution period. From unpublished data from MOE, Henan and Qinghai provinces experimented with Type 3 loan program, where the ratio between loan applicants and approved loan applicants was close to one. These are the only two provinces in China which reached that ratio, which indicates that students' need for loan is largely satisfied. The major problem of Type 3 loan program is that it demands HEIs to take great responsibility. On the one hand, HEIs have to pay a huge amount of risk compensation fund. On the other hand, they have to assume the role of loan collecting agency. For Type 4 loan program, the county-level student aid management center is responsible for loan distribution and collection; however, its capacity in fulfilling such duties is questionable. According to a recent study (references??), this kind of centers is weak in institutional capacity, personnel displacement, facility management and etc. They were also failing to show advantage in household income identification and loan collection. Therefore, government should be cautious in promoting such programs at national level.

In summary, the feasible option for the future is to allow competitions among different loan schemes, instead of promoting a single kind of student loan program. Central government should also keep sufficient space for local governments to find the most appropriate student loan program for their regions. This practice might create conditions for the appearance of more matured student loan program.