

# The Hungarian student loan scheme: six years of financing access to higher education

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*Hungary's higher education system has been going through a gradual shift from an elite to a mass system: enrolment has surged in recent decades. There is growing pressure on financing, with rising costs, limited public funding and an increasing student population. In parallel, there is a growing recognition that an important part of the benefits of participation in higher education is private, which is part of the justification for sharing the cost of education between students and taxpayers. The implementation of a student loan programme is fundamental for ensuring that financially needy students have access to higher education, to further stimulate the growth of private higher education, and for raising the political feasibility of levying tuition fees for all first-degree students. Accordingly, a new institution – Diákhitel Központ – was established in Hungary in 2001, with the objective of granting loans for higher education students.*

*The results from a comprehensive research study indicate that those students who come from poorer financial or income status families are more likely to ask for a loan, enabling them to benefit from the higher education system. The student loan programme provides Hungary with a potentially important instrument for the support of further institutional and policy change in HE.*

Keywords: student loans, equity of access, higher education, financing

Hungary's higher education system has been going through a gradual shift from an elite to a mass system. The last couple of decades have been characterised by a spectacular increase in the number of students, which has caused growing pressure on HE financing (see Table 1).

Despite the fact that government spending on HE consistently increased until 2003 (see Table 2), public funds were proving increasingly insufficient to finance the sector, given increased demand, the increase in the cost per student and the need to supply a highly-skilled workforce to meet the challenge of the knowledge-based

TABLE 1  
*Numbers of higher education students*

Academic year	First year full time students	Total first year students	Total number of students
1960-61	8,369	14,619	44,585
1970-71	15,147	25,435	80,536
1980-81	17,886	29,324	101,166
1990-91	22,662	32,067	108,376
1997-98	45,669	81,214	254,693
1998-99	49,705	90,175	279,397
1999-00	52,618	98,172	305,702
2000-01	54,592	103,905	327,289
2001-02	58,929	112,933	349,301
2002-03	61,210	124,965	381,560
2003-04	74,038	127,484	409,075
2004-05	64,590	125,051	421,520
2005-06	66,378	122,901	424,161
2006-07	65,665	111,063	416,324

Source: Ministry of Education

economy. In Hungary, due to a constrained budget, only about 50 per cent of HE students are now (partially) financed by the state; and the remaining 50 per cent are self-financed: in the academic year 2006-07, as many as 218,704 students (out of 416,324) paid for their own education.

### **Self-financed education in Hungary**

Since 1996, higher education institutions have been able to accept students paying the costs of their education (self-financed). In a nutshell, the fundamental difference between state-financed and self-financed education is that in the former the direct costs of education are covered by the central state budget, while in the latter these costs are covered by the student. The total number of students who can be admitted to HE as state-financed students is determined by the Government every year. The coexistence of state-financed and self-financed students is not uncontroversial, however. Self-financed students contribute more towards their tuition costs, and at the same time receive fewer benefits from the state than state-financed students. This practice raises equity issues between the two groups of students.

The fee for self-financed education is determined by the institution itself and does not need to abide by any special rules (the only regulation that exists concerning fees is that they have to cover some minimum amounts). Institutions are free to differentiate fees across fields of study,

TABLE 2  
Public expenditure on educational institutions ( current prices, million HUF)

	Tertiary expenditure	Total public expenditure	Public expenditure on educational institutions per full-time equivalent student (in HUF)	Total public education expenditures as a % of total public expenditure	Tertiary education expenditure as a % of GDP	Education expenditure as a % of GDP
1980	3,885	245,95	nd	5.69	0.54	3.41
1990	16,843	118,002	216,149	9.56	0.81	5.68
1995	54,004	306,525	387,876	8.56	0.96	5.46
1996	58,594	340,562	381,822	8.66	0.85	4.95
1997	80,378	425,587	476,557	10.03	0.94	4.98
1998	91,985	493,240	489,787	9.75	0.91	4.89
1999	110,654	590,066	546,553	11.02	0.97	5.18
2000	143,239	672,943	660,562	11.13	1.06	4.97
2001	155,379	770,879	679,886	11.39	1.02	5.05
2002	176,473	932,529	729,034	10.98	1.03	5.42
2003	207,604	1,071,456	799,639	12.30	1.10	5.66
2004	205,179	1,089,090	747,097	10.74	0.99	5.26
2005	216,554	1,170,113	766,048	10.42	0.98	5.31
2006	224,544	1,216,135	788,306	nd	0.95	5.16

Source: Central Statistical Office

allowing amongst other things to reflect ex-ante the potential rate of return to education, varying with the type of studies. Generally speaking, all state HE institutions have state- and self-financed students, but for some fields within a given institution, a state-financed version may not exist and therefore all students must pay fees. In private institutions, usually all students pay tuition fees, but there are some thousands of students financed by the state in private HE institutions. The selection system and the attribution of the state-financed status is an academic performance-based system. In a nutshell, one could say that the Government pays those for 'one undergraduate degree' for students that have good academic performance at the time of entry. Those students who reach the minimum number of points required at the university/college entrance examination (after obtaining the final examination secondary education certificate) will be financed by the state. But the number of state-financed students that each institution is allowed to enrol is determined independently by the Ministry. The minimum number of points is determined differently every year, and depends both on the institution attended and the field of study. In practice, there is a quota for each institution on the number of state-financed students that can be admitted, which is based on the overall budget allocation from the Ministry of Finance to the Ministry of Education. The quotas are estimated backwards, based on the norms for the different type of degrees, the number of students, and the type of institution. Only state-financed students who are in full-time undergraduate education can benefit from a variety of financial aid schemes, *inter alia*, cheap accommodation at a dorm, scholarships for books, and other scholarships of the Hungarian Republic.

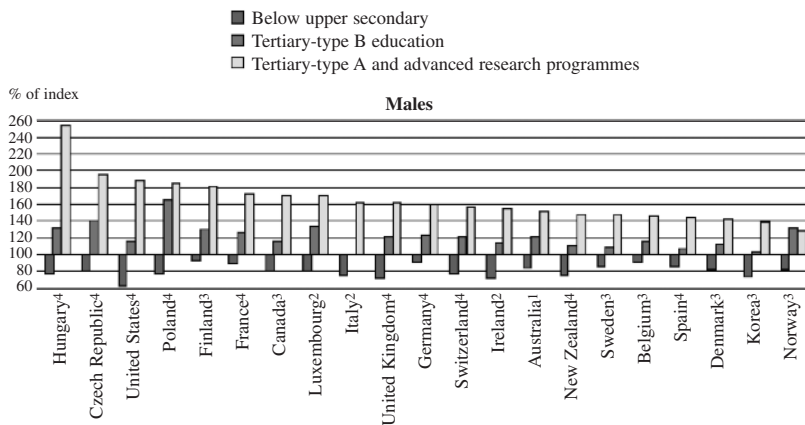
Because of public budget constraints, only about 50 per cent of students are financed by the state; the remaining 50 per cent are self-financed. Annual fees currently range between HUF 50,000 (EUR 195) and HUF 600,000 (EUR 2,344) for an international business programme. In addition, even students that are state-financed may incur significant expenditure necessary to finance their degrees: inexpensive accommodation in student dorms is in short supply, meals are not paid for, scholarships for books are insufficient to cover the costs. In fact, in the 2006-07 academic year, 59 per cent of the recipients of a student loan participated in state-financed education, and only 41 per cent were fully financing their own studies.

In this context, where almost all students face substantial private direct costs (as high as EUR 7,000 a year), and public funds are proving increasingly insufficient, increasing the scale of private funding in HE seems to be the strategy to pursue. This requires a good student loan

scheme in place if equality of opportunity in access to HE is not to be jeopardised. Accordingly, in 2001, the Hungarian Government established Diákhitel Központ to assist Hungarian students in financing the direct costs (fees and living costs) of their HE studies.

### Benefits from a loan scheme

There is a growing recognition that an important part of the benefit of participation in HE is private (wage premium, lower risk of unemployment, higher social status), which is part of the justification for sharing the cost of education between students and taxpayers. In fact, among OECD countries, in Hungary, employees with higher education have the highest wage premium (2.35 times) vis à vis secondary education graduates (see Figure 1).



Source: OECD, Education at a Glance, 2006

Figure 1: Relative earnings from employment (males, 2004 or latest available year, upper secondary and post secondary non-tertiary education = 100)

For the individual, attending higher education represents an investment, generating benefits in the form of higher earnings potential later in life, but which, in the absence of government intervention, can only be undertaken if students are able to raise the necessary upfront cash requirement. The presence of a liquidity constraint for students is expected to affect more students from disadvantaged backgrounds with three major effects: a loss of talent since high-ability low-income students are deterred from applying for HE, generating an efficiency and a social loss; a loss of opportunity for individuals; and a strengthening of the link between family background and a person's lifetime income.

The implementation of a student loan programme is fundamental for ensuring that financially needy students have access to HE, for further stimulating growth of private HE, and for raising the political feasibility of introducing fees for all first degree students.

Another potential benefit of a loan scheme is increased internal efficiency of institutions. The greater responsibilities of students in financing their studies should reinforce the accountability of institutions to attract them and retain them until graduation. The implementation of the student loan scheme enables a revision of the tuition fees policy, which will increase the amount of funding derived from tuition fees in the total budget of the institution. As a consequence, there will be increased competition between institutions for the marginal student.

### **Private returns to education**

For an individual, the rewards from HE are clear: those with higher qualifications earn, on average, far more over a lifetime than the less qualified; and they have a lower exposure to unemployment risk – lower probability of being unemployed and shorter unemployment spells. During 2005, average gross monthly wages were HUF 159,532, which is three times the minimum wage, but an individual holding a HE degree could expect to earn HUF 353,540 per month, about 2.2 times above the average earnings of the economy. The unemployment rate was 7.2 percent, but as predicted, the probability of being unemployed strongly decreased with the education level as displayed in Table 3.

TABLE 3  
*Average monthly gross earnings and unemployment rates by level of education, 2005*

Highest level of qualification	Average monthly gross earnings	Unemployment rate
8 grades or less	90,537	35.3
8 grades	97,526	13.6
Industrial and technical school	101,980 – 110,605	8.1
Secondary school (academic)	146,499	7.1
Secondary school (vocational)	143,835	5.4
College	243,671	3.0
University	353,540	2.2
Average	159,532	7.2

Source: Central Statistical Office

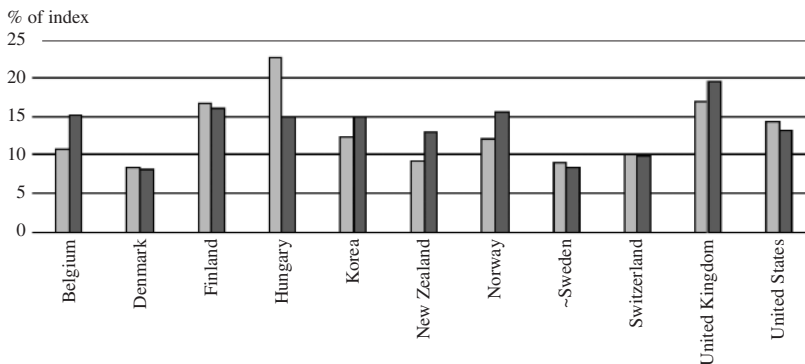
In order to evaluate the private benefits for a student, we estimated the internal rate of return (Table 4). On the cost side one has costs of studying; opportunity costs of pursuing studies corresponding to foregone wages; and costs of borrowing. The stream of private benefits corresponds to the expected wages over a lifetime following graduation. Accordingly, the individual internal rate of return for the students is estimated to be between 10.3 percent and 25.5 percent, showing the potential high private benefits of investing in HE.

TABLE 4  
*Expected yearly wages of university graduates and internal rates of return*

Possible scenarios	Expected yearly wages of a university graduate	Internal rate of return (%)
Average costs of studying	1,800,000	13.9
500,000 HUF: 18 years repayment	2,000,000	15.1
	4,242,480	25.5
Average costs of studying	1,800,000	10.3
1,500,000 HUF 18 years repayment	2,000,000	11.3
	4,242,480	20.0

Source: Author's own calculations

These estimates are confirmed from sector-wide estimates of rates of return from OECD (see Figure 2), which show that in all countries, for males and females, private internal rates of return exceed 8 per cent on an investment in HE (when completed immediately following initial education), and that in Hungary they exceed 20 per cent for males and they are about 15 per cent for females.



Source: Education at a Glance, OECD 2006

Figure 2: Internal rates of return (males:females)

### The Student Loan Centre and the Student Loan Scheme

The Student Loan Centre (SLC), Diákhitel Központ, is a company limited by shares, owned by the Hungarian State ('the shareholder'). Its main task is to manage loan accounts, to disburse loans to students, to collect repayments and to manage the student loan as a financial product. Its other important field of activity is raising the necessary funds for loan disbursement.

At its inception, the sole owner was the Ministry of Education (MoE). In August 2001, Postabank became the sole owner of the company. After that, Magyar Fejlesztési Bank (MFB, the Hungarian Development Bank) exercised a capital increase and then bought the shares from Postabank, becoming the 100 per cent shareholder until

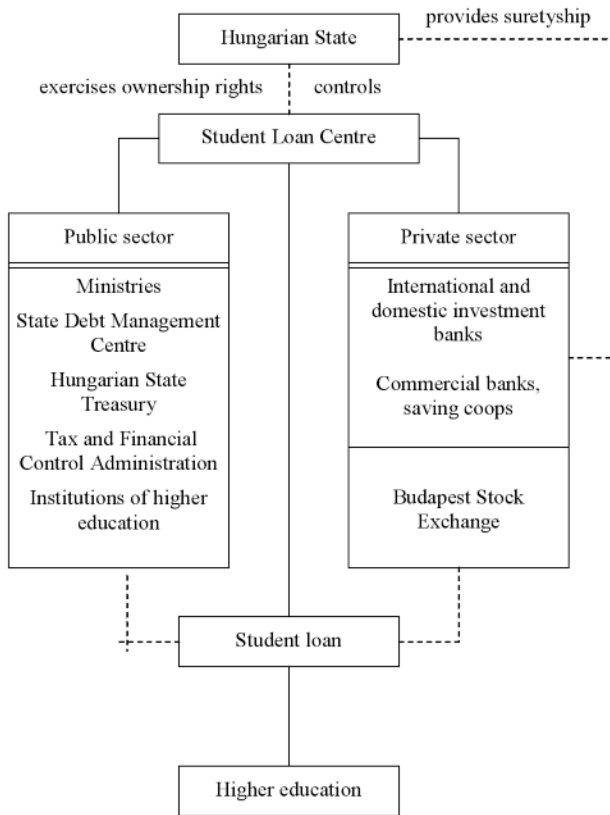


Figure 3: Student loan scheme: ownership

December 2002, when 100 per cent of the shares were bought back by the Treasury Property Directorate. Shareholder rights were exercised by the Ministry of Finance (MoF) since then, until 1 January 2008. In addition to control and supervision, this includes the provision of various services to Diákhitel Központ (eg tax collection from the state tax authority). As of January 1, 2008 Magyar Nemzeti Vagyonkezel Zrt (the Hungarian National Property Management Ltd) exercises the ownership rights on behalf of the Hungarian State

ACT CXXX of 1993 on Higher Education did not contain any provisions on student loans. Until the promulgation of the new Act on Higher Education – Act CXXXIX of 2005 on Higher Education – the system of student loans was regulated by the Government Decree on the Student Loan System and the SLC. First and foremost, the change to the law reflects the increased strategic importance of student loans as part of a well-functioning and equitable HE system: the new Act provides that each student has a right to receive a student loan, including Hungarian students going abroad, and provides differentiated amounts of borrowing depending on whether the student is self- or state-financed. In practice, the student loan scheme is a result of cooperation between the public and private sector (see Figure 3).

### **Sources of financing**

Although the sole shareholder is the Hungarian State, Diákhitel Központ raises its funds from money and capital markets. The State provides a guarantee for all the Diákhitel Központ's payment obligations undertaken to finance the student loan scheme. Strictly speaking, although there is no guarantee for the repayment of the individual student loans, the Government incurs a substantial contingent liability on behalf of the SLC. Loans taken out from a state-owned investment bank and the subsidy from central budget were the main sources for student loan financing in the first and the second years of operation. A new financing tool, the issuing of bonds, was introduced in the academic year 2003-04, financing a high percentage of funds; while in parallel the importance of repayments and prepayments from clients have increased steadily since 2003-04. Since 2005 the European Investment Bank provided long term resources for the Hungarian student loan scheme, reducing the maturity mismatch between the expected maturity of Diákhitel Központ's assets and the maturity of student loans provided by the SLC.

In the past, Diákhitel Központ has also received Government funding to cover some operating costs and the risk premium in order to maximise the transfer of benefits to students. As of the academic year 2005-06,

funds for the operation of the student loan scheme – including covering default risk or operating costs – come exclusively from the money and capital markets, and not from the government budget.

### **The student loan scheme: how does it work ?**

The operation is governed by a specific government decree, recently modified (Government Decree No 86/2006 (IV.12)). It updates Government Decree No 119/2001 (VI.30), which sets out the terms and conditions of student loans and the legal framework for the operations of the company. Eligibility for the loan does not require individual loan assessment and risk appraisal: all Hungarian citizens under the age of 40 enrolled at an accredited HE institution in Hungary or in the European Economic Area (EEA) are eligible, irrespective of family background and financial means. (The change in eligibility to enable Hungarian students studying abroad to borrow was introduced with the new Higher Education Act and the 86/2006 (IV.12.) Government Decree on the Student Loan Scheme and Student Loan Centre. Foreign students, if enrolled in a Hungarian HE institution, are citizens of a country inside the EU/EEA area, are employed, and they or their relatives have a permanent residence permit in Hungary, are also eligible. No parental guarantee is required. Academic performance is only implicitly taken into consideration as an eligibility criterion. The credit application period – the period within which the borrower may request a student loan – and the eligibility period – maximum number of years in total for which the borrower may actually receive a student loan – are determined by the degree that the student is pursuing, according to the HE institution's regulations.

The maximum amount of the loan is set by decree. During the academic year 2001-02, the maximum amount of the loan per student was HUF 210,000. During the academic year 2003-04, the student could choose between HUF 100,000, HUF 150,000, HUF 210,000 or HUF 250,000 per year. From the 2005-06 academic year, the maximum yearly amount of the loan was increased to HUF 300,000 (still with three amounts to choose from). During the academic year 2006-07, the annual amount of the loan varied between a minimum of HUF 100,000 and a maximum of HUF 300,000 (EUR 1,178 equivalent) for state-financed students and HUF 400,000 (EUR 1,570 equivalent) for self-financed students per academic year. Since September 2008, the maximum amount of the loan was raised to HUF 400,000 and HUF 500,000 for state-financed and for self-financed students, respectively. The loan is paid in two lump sums or in 10 equal monthly instalments.

## **The project cycle**

Diákhitel Központ's partner banks and the post office outlets are responsible for receiving applications from students and checking the data for accuracy. In total there are more than 1,000 places nationwide where the student can obtain the form. The application is submitted together with the national ID Card, so that the data in the application can be checked for consistency and screened for basic eligibility (age, nationality, etc). The applications are then sent to Diákhitel Központ, which, in cooperation with the HE institutions, checks for eligibility. The procedure is relatively quick: a student who submits an application by the middle of the month during a given academic year can expect to have the money deposited in his/her bank account in the following month.

Diákhitel Központ disburses the loans directly to a bank account of the student's choice. Once the borrower enters the repayment phase, Diákhitel Központ is responsible for collecting and monitoring repayments, and, in the event of default, handing over to the Tax Authority for the recovery of the debt.

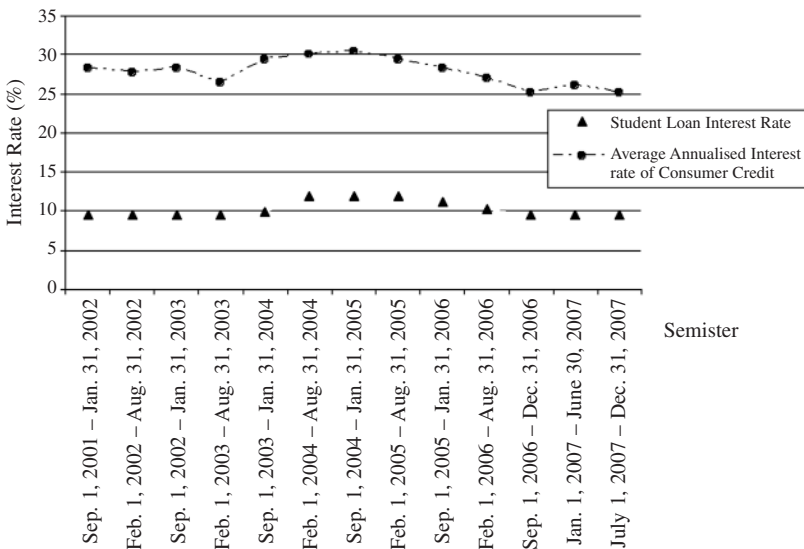
## **Cost of the loan to the student**

SLC is a non-profit economic entity: students must receive the student loan at the lowest possible costs under the given market conditions. According to the regulation, the student loan scheme must operate in a self-sustaining manner, ie the pool of borrowers must finance the loan losses and the operating costs as well. This is achieved by allowing the company to add to the weighted average cost of capital when raising funds a premium to cover credit risks (default as well as the losses Diákhitel faces when the borrower reaches the retirement age, becomes eligible for a permanent disability pension, or dies) and operating costs. According to the Government Decree, the premium cannot exceed 4.5 percentage points. In the first three years of operation, the Government subsidised Diákhitel Központ's operating costs and only part of the risk premium was charged to the borrowers. Currently, the entire risk premium is financed by the borrowers.

Diákhitel Központ operates on a non-profit basis. Loans carry a variable interest rate based on the weighted average cost of funds of Diákhitel Központ, plus a premium to cover risks and operating costs. The calculation method of interests charged to the students is determined by 86/2006 (IV.12) Government Decree on the Student Loan Scheme and Student Loan Centre. Until now, Diákhitel Központ has been borrowing its funds in the short- and medium-term domestic capital market (namely bonds have been issued with a maximum

maturity of three years), while the expected average duration of the student loan is 21 years (three years of payment phase and 18 years of repayment phase). The recourse to financing with a long maturity will contribute to reducing this mismatch between short-term borrowing and long-term lending. The EIB's financing at favourable interest rates will result in a reduction in Diákhitel Központ's cost of funds and the benefit of that will be passed on directly to students as Diákhitel Központ operates on a non-profit basis. In addition, with a lower interest rate, *ceteris paribus*, the repayment periods will become shorter, which will contribute to reducing the credit risk. In addition, the EIB may act as a catalyst, helping Diákhitel Központ attract other longer-term funding sources, which would further contribute to reducing the costs of borrowing money and therefore also contribute to lowering the cost of loans to students.

Loans carry a variable interest rate, revised twice a year before the forthcoming semester. Interest accrues on the loan from the date of disbursement to students until the loan is repaid in full. Interest is compounded annually, and is consistently and substantially lower than the annualised interest rate of consumer credits as Figure 4 shows.



Source: Central Bank of Hungary, Student Loan Centre

Figure 4: Student loan interest rate compared to annualised interest rate of consumer credit

The risk premium is calculated by an independent actuary. The model categorises borrowers into more than 300 groups by age, gender and the academic years left until graduation. For each of the borrower groups, the model estimates the expected average repayment path, taking into account the probabilities of events which affect the level of repayment, such as different activity patterns, parental leave, unemployment and under-declaration of income. It then looks at the risks of non-repayment using mortality rates, disability rates, probabilities for inactivity, parental leave and the lack of discipline to pay.

Between 2001 and 2007 the risk premium has varied between 1.0 and 2.0 percentage points. As Figure 5 shows, the risk premium as a percentage of the interest rate charged to clients has been quite stable since the inception of the scheme.

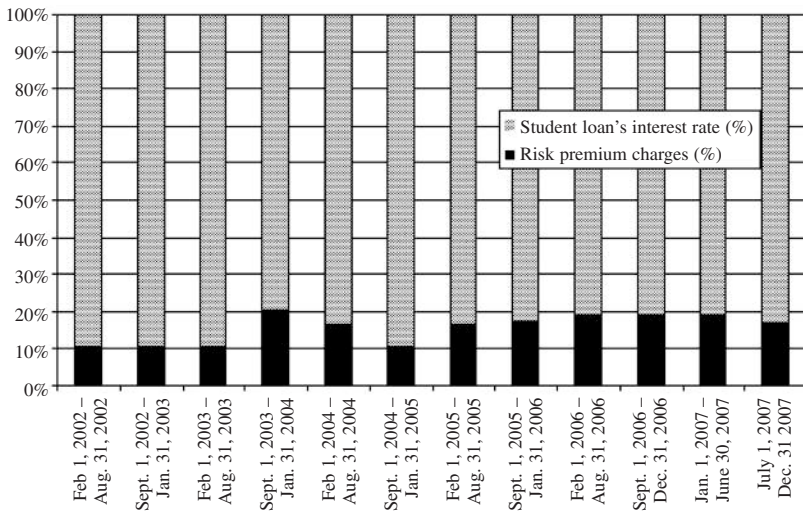


Figure 5: Risk premium charged as a percentage of the loan's highest rate

### Income-contingent repayments

Repayments are lagged income-contingent (except for unemployed people who still have to pay a percentage of the minimum wage). For the first two years, repayments are set at 6 or 8 per cent of the minimum wage of the previous year, depending on the amount of the loan. Thereafter, the student pays at the higher rate of 6 per cent (or 8 per cent) of their average gross monthly income two years preceding the current year or 6 per cent (or 8 per cent) of the minimum wage, until the loan is repaid. The two-year lag was chosen for practical reasons. The tax

declaration for income earned during a fiscal year is submitted at the latest by May t+1. Since the repayment is determined at the end of the year t+2 for the whole year, then this lag of two years is necessary to use the structures already in place. The increase in the student loan amount and how it may impact the financial stability of the student loan scheme was investigated. Increases in the student loan amount are compatible with an unchanged premium risk if the repayment rate is higher. Accordingly, students that request HUF 500,000 a year have a repayment rate of 8 per cent of income.

The State Tax Authority provides income data to Diákhitel Központ, based on which the company calculates the monthly repayment obligations of its borrowers. By the end of each year, Diákhitel Központ issues automatically a letter to be sent to the borrower containing the annual payment obligation for the following year. There are no special financial incentives to make extra repayments, other than the fact that the amounts paid in advance are deducted from the principal of the borrower. Pursuant to the act on personal income tax, neither the principal, nor the interest payment effected by the debtors of student loans can be taken into account as allowable deductions from either the taxable income or income tax. If the annual income of the borrower required to make repayments does not reach 12 times the minimum wage, the repayment obligation is determined on the basis of monthly repayments, and is 12 times the minimum wage in effect on 31 October of the year preceding the year in question.

In the beginning, there was no grace period and students were placed under an obligation to start repayments, due the 5<sup>th</sup> of the month immediately following the student's graduation or where the student ceased to have student status. As a consequence, many students were recorded with payments in arrears only because they had not had the time to adjust to their new status. This led the regulators of the student loan scheme to introduce a three-month grace period, the longest period compatible with the financial sustainability of the system.

The design includes additional 'income-contingent' safeguards. In the event of parental leave or temporary disability, the borrower may request the suspension of repayments; and customers with young children receiving maternity allowance or child care allowance can also benefit from interest payments covered by the Central Government budget. Previously, when civil service and military service were compulsory, the borrower could also request suspension of repayments. If the borrower reaches retirement age, becomes eligible for a permanent disability pension, or dies, their debts are cancelled, which constitutes a loss for Diákhitel Központ.

## Payments in arrears

Repayments are due at the beginning of each month, and can be made exclusively by bank remittance. When the borrower enters the repayment phase and fails to fulfil his repayment obligations – whether fully or partially – technically he falls into arrears with his payments, and is charged a penalty interest on the amount overdue. Diákhitel Központ corresponds with the borrower about his arrears using various levels of warnings, depending on the amount overdue and the duration of non-payment. Clients in arrears are warned in writing several times, and if they do not react, their contract is terminated. The general rule is that a client's contract – if closed after 1 January 2003 – is terminated if arrears exceed the six-month repayment obligation. The corresponding condition for a client whose contract closing date is before 2003 is 12-month arrears. When the contract is terminated, the borrower is required to clear his outstanding debt. If the borrower discharges his debt within the specified time limit, the contract can be closed. If the borrower fails to pay and has not received permission for deferred payment, Diákhitel Központ hands over the recovery of the debt to the Tax Authority (APEH) in accordance with the current legal regulations. If the unpaid debt is at least equal to the current minimum wage in force for 90 days, the existence of the arrears is recorded in the Hungarian Official Bad Debtor Register – the *Central Credit Information System*. In the case of borrowers moving abroad, the Tax Authority is still responsible for recovering the debt in the event of default.

## Experience to date with the borrowers

### *Demand and profile of borrowers*

Even though the company began lending only in October 2001, together with the fact that there was no tradition of borrowing money for education in Hungary, the total number of students benefiting from a loan in the last six years is substantial (see Table 5).

TABLE 5  
*Demand for student loans*

	<b>New loan applications</b>	<b>Total number of borrowers (includes those in repayment phase)*</b>	<b>Total number of borrowers in repayment phase*</b>	<b>Number of HE students</b>
<b>2001-02</b>	85,416	85,416	0	349,301
<b>2002-03</b>	42,675	128,091	15,500	381,560
<b>2003-04</b>	33,111	161,202	33,583	409,075
<b>2004-05</b>	23,063	184,265	54,043	421,520
<b>2005-06</b>	26,020	210,340	74,573	424,161
<b>2006-07</b>	23,822	234,162	85,338	416,324

\* As of 30 June of respective calendar year

Source: Student Loan Scheme in Hungary, (issued by Student Loan Centre)

The borrowers seem to be evenly distributed in geographic terms in Hungary as Table 6 shows.

TABLE 6  
*Geographic distribution of borrowers (2006-07)*

<b>Region</b>	<b>Number</b>	<b>Percentage of total</b>	<b>Percentage of eligible students in Hungary</b>
Budapest	18,122	0.19	0.21
Bács-Kiskun	4,601	0.05	0.23
Baranya	4,733	0.05	0.30
Békés	3,647	0.04	0.26
Borsod-Abaúj-Zemplén	7,242	0.08	0.25
Csongrád	3,997	0.04	0.23
Fejér	4,683	0.05	0.29
Gyor-Moson-Sopron	2,805	0.03	0.17
Hajdú-Bihar	5,183	0.05	0.24
Heves	2,803	0.03	0.22
Jász-Nagykun-Szolnok	4,080	0.04	0.28
Komárom-Esztergom	2,891	0.03	0.26
Nógrád	2,123	0.02	0.29
Pest	9,014	0.09	0.20
Somogy	2,958	0.03	0.26
Szabolcs-Szatmár-Bereg	6,102	0.06	0.26
Tolna	2,428	0.03	0.26
Vas	2,032	0.02	0.21
Veszprém	3,278	0.03	0.24
Zala	2,301	0.02	0.22
<b>Total</b>	<b>95,023</b>	<b>1.00</b>	<b>0.24</b>

Not unexpectedly, the proportion of self-financed students is increasing as Table 7 shows.

TABLE 7  
*Percentages of self- and state-financed students*

<b>Year</b>	<b>State-financed</b>	<b>Non-state financed</b>
<b>2001-02</b>	70	30
<b>2002-03</b>	66	34
<b>2003-04</b>	62	38
<b>2004-05</b>	61	39
<b>2005-06</b>	62	38
<b>2006-07</b>	59	41

Source: Student Loan Scheme in Hungary

### *Repayment behaviour*

As with any student lending scheme, there are bound to be delinquencies, but the most significant factor is the extent to which those turn into actual defaults. Diákhitel Központ can rely on an efficient Management Information System (MIS), allowing for a close and timely monitoring of borrowers during the repayment phase. In addition, Diákhitel Központ has developed internal procedures, strictly adhered to, on what to do if the borrower enters the repayment phase and fails to fulfil repayment obligations. By design, the Hungarian student loan scheme incorporates some extremely powerful features that should contribute to maintaining the default rate to a minimum, namely: repayments are lagged income-contingent; Diákhitel Központ benefits from the support of an efficient tax collection mechanism; and the level of indebtedness is relatively low.

Accordingly, Diákhitel Központ's total amount of payments in arrears as of end of December 2007 corresponds to less than 0.3 per cent of the total outstanding portfolio (see Table 8). Furthermore, of all the borrowers with arrears, close to 80 per cent had outstanding the equivalent of six or fewer monthly payments.

### **Improved equity of access**

Comprehensive research undertaken in Hungary by TARKI (Hungarian Social Research Center) indicates that those students who come from lower income families are more likely to ask for a loan. The research shows that a student loan scheme eases the conditions for participating in HE especially for those from a family with lower social-economic status, who receive a smaller amount of financial support from their families than the average student, and those students who pay higher fees than the average student. Twenty-six per cent of the students having a loan stated that they would not have been able to graduate without the financial support provided by the student loan; 23 per cent of the students with student loans required to pay fees stated that they would not have been able to pay the fee without the loan.

### **Recent changes**

Diákhitel Központ is building on its experience. The most important changes introduced with the decree amended in 2006 include, *inter alia*:

*Grace period.* Introduction of a three-month grace period after completion of studies to start repayment.

*Scope of eligibility.* The scope of eligible students has increased, covering now PhD students, Hungarian students studying in an

TABLE 8  
Some data on arrears (in %)

	30/06/2005	31/12/2005	30/06/2006	31/12/2006	30/06/2007	31/12/2007
Arrears as a percentage of total loan portfolio	0.196	0.246	0.278	0.225	0.259	0.235
Arrears as a percent of total outstanding loans of all borrowers in repayment phase	0.783	0.695	0.783	0.557	0.648	0.522
<b>Distribution of borrowers in arrears by duration (in %)</b>						
>360 days	2	3	3	2	3	2
91-360 days	36	37	39	40	33	37
<90 days	62	61	58	58	64	61

Source: Student Loan Scheme in Hungary

accredited HE institution in the European Economic Area (EEA); and students from EU/EEA area enrolled in a HE institution in Hungary if they are employed and legal residents for the required period in Hungary. This is consistent with and supportive of the EU objective of increasing mobility among higher education students.

*Amount of the loan.* Students who finance their own studies may apply for up to HUF 500,000 a year if they agree to a higher repayment rate of 8 per cent.

*Age limit of the loan application* was raised from 35 to 40 years of age.

## **Lessons learned and areas for improvement**

### *Amount of the loan*

The student loan can only be used for partially financing the costs of studies and living expenses of being enrolled in a HE institution in Hungary. The maximum level of the student loan is set to ensure sustainability of the scheme, but is still too low to enable any student to cover all typical expenditures (tuition, living costs, materials, etc), meaning that education is not free at the point of entry for all students, so poor students still face adverse conditions to participate in higher education. Table 9 presents an estimate of some direct costs the student might incur to pursue a degree and how they compare with the maximum amount of the loan.

The fact that more than 50 per cent of the borrowers take the maximum amount available may indicate the presence of a strong binding constraint as far as the size of the loan is concerned (see Table 10). But further increases in the student loan amount are only compatible with an unchanged premium risk, if the actual uniform repayment percentage is replaced with a variable repayment percentage that increases with age (which is consistent with the fact that earnings increase with experience (age)) and the degree of indebtedness of the borrower.

### *Relationship with institutions*

Diákhitel Központ maintains relationships with a large number of HE institutions in order to carry out its tasks in an efficient manner. There are fields of cooperation where further efforts are needed, and some initiatives are planned.

Currently, the student loan cannot be directly used for covering the fees charged by the majority of HE institutions, because Diákhitel Központ will not pay the loan to the student until the student's status is confirmed by the university. However the university will not confirm

TABLE 9  
*Academic year (10 months) expenditures (in HUF)*

	State-financed student living with family/relatives	State-financed student without a place in a dorm and living outside their family home	Non-state financed and not living with family/relatives
Accommodation	0	350,000 - 450,000	350,000 - 450,000
Meals	150,000 - 300,000	300,000	300,000
Tuition fees	0	0	180,000 - 800,000
Sub-total	150,000 - 300,000	650,000 - 750,000	830,000 - 1,550,000
Transportation	69,000	69,000	69,000
Books	30,000 - 70,000	30,000 - 70,000	30,000 - 70,000
Personal incidentals	150,000 - 200,000	150,000 - 200,000	150,000 - 200,000
Total	399,000 - 639,000	1,004,000 - 1,089,000	1,079,000 - 1,889,000
Maximum loan amount	400,000	400,000	500,000

Source: Author's own calculations

TABLE 10  
*Distribution of borrowers by loan category*

	Loan amount HUF 10,000/month	Loan amount HUF 15,000/month	Loan amount HUF 21,000/month	Loan amount HUF 25,000/month	Loan amount HUF 30,000/month	Loan amount HUF 40,000/month
2001-02	2	8	90	–	–	–
2002-03	2	6	58	34	–	–
2003-04	2	5	27	66	–	–
2004-05	1	5	20	74	–	–
2005-06	1	4	12	42	41	–
2006-07	0	4	8	28	46	14

Note: In 2002, the maximum monthly loan amount was increased from HUF 21,000 to HUF 25,000

Source: Student Loan Scheme in Hungary

the student's status unless the student has paid the fee (a 'chicken and egg' problem). In order to solve this problem, during the course of 2008 Diákhitel Központ launched a pilot initiative, the 'assignment project', whereby HE institutions undertake to cooperate with the Student Loan Centre, so the money for the tuition fees payment can be transferred directly to the institution on registration. Students attending an institution that is part of the project are required to complete an assignment data sheet which authorises the Student Loan Centre to transfer part or all of the student loan to the institution. The loan application procedure remains unchanged: the student still applies for the loan at the post office or at a partner commercial bank.

Students cannot currently apply for a student loan, or handle related issues directly with the institution. In the future, Diákhitel Központ aims to use the student administration offices at the institutions to make student loans easier to apply for and administer. This would stimulate the demand for student loans and make the administration more convenient for the students.

### **Hungary in an international context**

Student loans cannot be viewed in isolation. Rather they need to be interpreted as a component of the funding model of higher education. In Europe, higher education is still largely financed and organised by the public sector, and in many countries the independent private sector is practically non-existent. About half of the EU countries require students

to pay some tuition fees that can range from EUR 200 per academic year in Luxembourg, to as much as EUR 4,300 in the UK. Whether students are required to make a contribution or not, be it in the form of registration or tuition fees, they will incur other costs associated with studying, such as books, transportation, accommodation, etc. The most widespread form of financial support for students in tertiary education, studying for their first qualification, is grants (Eurydice, 2007), sometimes combined with loans. In countries like Denmark, Germany, Luxembourg, Finland or Sweden, financial support for students is a combination of grants and loans: the proportion of grant and loan in the package depends on national policy in the given country, though the eligibility conditions for grants and loans are similar. In Iceland and Latvia (for students without a subsidised place) – financial assistance only exists in terms of loans. In another group of countries – Portugal, Hungary, New Zealand – financial assistance is a combination of grants and loans, but while grants are means-tested based on parent's income (and often not enough to cover all direct costs), loans are universal, based on the principle of the students' financial independence, and provide a supplementary source of income; they exist for all students regardless of income and without any scoring or debt risk assessment. Finally, in Belgium, Bulgaria and the Czech Republic, only grants are available.

The combination of several principles and characteristics produces an array of student loan schemes. Well-designed student loan schemes have three core characteristics (Barr, 2001, 2008): full income contingent repayments; loans are large enough to cover the full cost of studying (tuition fees and living costs) so that education is free at the point of use; and the price of the loans is related to the government cost of borrowing, ie, there are no government subsidies of the interest rate. Other desirable attributes include the scheme is linked with satisfactory completion of studies; and portability, ie loans are available for studies outside the country, to enhance mobility.

The Hungarian loan scheme has two of the three core characteristics: First, repayments are (close to full) income contingent. Other countries that have successfully implemented income-contingent loans are the UK, New Zealand, and Australia (see Chapman, 2006 for a review of international experience with income contingent loans). Second, interest rates are not subsidised and are related to the government cost of borrowing. Interest rate subsidies are very expensive (Ziderman and Albert, 1995) and unnecessary: the experience in Hungary, Netherlands, Sweden and Norway has shown that positive real interest rates are politically feasible. Unfortunately, the third core characteristic is not

fulfilled. The loan amount is not enough to cover the costs of education so education is not free at the point of entry: poor students that do not have a subsidised place at a Hungarian University will not be able to make ends meet with the loan available. The loan amount that would be necessary to cover all costs would compromise the self-sustainability of the system.

A review of international student loan experience also indicates that in countries providing loan support to students the terms involved are always better than market terms, thanks to some form of government intervention, *inter alia*, management of the loan award and repayment process, financing of the student loans, and/ or provision of guarantees. Diákhitel Központ benefits from a government guarantee to raise funds to on-lend to students but there is no guarantee for debt repayment by students in the event of default, whether partial (as in Portugal, Italy) or full (eg Luxembourg, Germany). In the literature one frequently reads that a critical aspect of an income-contingent loan's successful implementation is having a taxation system in place that could be used to collect student's repayments efficiently. Hungary (like South Africa) chose to use the tax system as a back-up, with Diákhitel being responsible for debt collection in the first instance. In countries such as Australia, New Zealand and the UK, repayments are collected directly through the debt system. Notwithstanding, Diákhitel relies on the Tax Agency, a government state agency, to recover the debt in the event of default.

Another important feature of the Hungarian system worth highlighting is the source of funding. Funds are usually provided by the public sector, although there is no reason why funding could not come from the private sector. And that is exactly the Hungarian experience. Despite the student loan scheme being managed by a state-owned company, funds for the operation of the student loan scheme come from the money and capital markets, and not from the central state budget. In many other systems (eg Nordic Countries, Australia, New Zealand, UK) funds come from the central budget. The Hungarian system is also different from systems where commercial banks disburse their own funds (eg Luxembourg and Portugal) or 'transfer' funds coming from the central budget: in Spain student loans are available from private banks, partly funded by the state (see Table 11).

Often student loans have (at least partially) an element of 'conditional grant' linked with satisfactory completion of studies: debt is cancelled or reduced if students complete their studies within the required period, or to a high standard. In Portugal, students with better than average marks will pay a lower interest rate. In the Netherlands

TABLE 11  
*Hungary: student loan income: an international comparison*

	<b>Source of financing (capital markets)</b>	<b>Repayment conditions</b>	<b>Interest rate</b>	<b>Is financial assistance enough to cover full costs?</b>
Hungary	Private	Close to full income contingent	Interest rate linked to the cost of borrowing	No
Norway	Central budget	Mortgage (20 (20 years) with income contingencies built-in	Interest rate of government bonds	Yes
Netherlands	Central budget	Mortgage type (15 years) with some income contingencies built-in	Subsidy of interest rate	Yes
Australia	Government budget	Income contingent	Zero real interest rate (subsidy)	No
New Zealand	Government budget	Income contingent	No interest (subsidy)	Only partially

the basic loan is transformed into a grant if the student graduates within 10 years.

It is important to emphasise that every country needs to adjust the HE financing system to its economic and cultural background. The Hungarian case may serve as a good example for other countries planning to introduce a new student loan system, because the loan product is relatively inexpensive for students, and it is self-financed not introducing additional costs for the government. So far defaults are modest, too. Although there are areas where it can be improved, this type of student loan system gives a chance to meet the challenges of financing HE in a country where the HE system has been going through a shift from an elite to a mass education system, the available financial resources from the central budget are limited and a loan system has not existed previously.

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