FEASIBILITY OF ESTABLISHING A NEW NATIONAL STUDENT LOAN PROGRAM IN UKRAINE

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By
Catherine D. Mayes
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Introduction

In response to a request of Ukrainian President Leonid Kuchma, the National Bank of Ukraine ("NBU") outlined a proposal[1] for a new, national student loan program based on experiences within the country. On October 2, 2003, the NBU requested assistance from the United States Agency for International Development for comment on the feasibility of a new student loan program in Ukraine and, more specifically, on its proposal. This report is the result of that request for assistance.

Conclusions

A new student loan program is feasible in Ukraine and can bring some broad benefits to the higher education sector. Without an effective student loan program, students frequently end up studying for occupations that do not suit them simply because their parents had connections in certain places or because students were unable to qualify for free training in the occupation they preferred. By freeing students from the constraints of their families' connections and economic resources, they will have choices to pursue areas of study that hold appeal to them and for which they are better suited. This will create a new energy among faculty and competition among universities[2] that will improve the quality of the curriculum and the skills of the staff. In addition, giving students some personal financial responsibility for their own education should motivate them to apply themselves more diligently to their studies. All these outcomes should lead to a better quality of higher education in the country generally.

The NBU proposal can form the basis for a student loan program that meets the needs of a large number of students who are unable to qualify under existing student loan programs. It has the attribute of being broadly available to students at both public and private universities, and contemplates interest rate subsidies and certain guaranties from the government.

The student loan program can be financed by decreasing the number of state order students[3] at least by half, more if politically possible, and holding the total budget spending on higher education steady, even as the total number of students declines, which

[1] Attached hereto as Exhibit 1.
[2] Ukraine, like the United States, has several kinds of institutions of higher education, including colleges, institutes, academies and conservatories. For the purpose of this paper, the term "university" is used as a short hand for the more general term, "institution of higher education." The differences among types of institutes of higher education do not affect the analysis and conclusions herein.
[3] A more literal translation of "state order student" might be "budget student," a student whose cost of attendance (tuition and living expenses) is paid out of the national or regional budget, but the phrase "budget student" has a slightly derogatory connotation in English.

is likely due to declining birth rates.[4] In addition, it must be expected that decreasing the number of state order student positions will result in a decrease in the number of students, because some students who might have been willing to attend university as a state order student may be unwilling to attend as a paying student, even with a student loan to help cover the cost.

In order to develop a student loan program, it is suggested that the following actions be undertaken

Action Item: Collect Information on Students' Ability to Repay

The single biggest barrier to establishing a sound student loan program is the lack of information on the ability of graduates to earn wages sufficient to repay their loans. Students and their families have a general idea that university graduates enjoy higher lifetime income than non-graduates, and that some careers promise higher lifetime income than others, and there is a general sense that graduates of some universities enjoy higher lifetime income than graduates in the same profession from other universities. However, systematic data do not exist to permit students to assess with any objectivity their ability to earn sufficient income in their specific career after attending their chosen school to repay the specific amount they might borrow to attain that career and still maintain a reasonable standard of living. This lack of data also makes it difficult for the government to make fiscally sound decisions about the amount students should be permitted to borrow and whether additional subsidies may be necessary to induce people to study less lucrative fields that are nonetheless critical for public policy reasons.

The best way to develop comprehensive income information would be to engage in a broad survey of salaries and living costs over the past 10 years and repeat it regularly. Because of significant underreporting of income for tax purposes, such surveys will need to be thoroughly validated to produce reliable data.

At the very least, the new loan program should be offered only to students attending universities that survey their graduates and provide the information to potential student loan borrowers. Although these surveys do not enable potential new students to compare the alternative of not attending university, in every country where the earnings potential of non-university graduates has been studied, those with university preparation were substantially better paid, and for the many students from families without university education, the comparison can be made based on personal experience. The more difficult decision for some students may be whether to borrow, or how much to borrow, for the specific stream of income projected based on their particular educational plans.

If students are given good information upon which to make the decision to borrow, then it is more realistic to hold them responsible for the consequences of over-borrowing.

[4] The Ministry of Education is planning to retrain a substantial number of people currently employed as police or soldiers in connection with the country's application to join NATO. This may temporarily offset the decline in numbers of university students otherwise anticipated.

Action Item: Confirm Sources of Funding

The second significant challenge for the new national student loan program is capital. The NBU proposes to establish a fund (called the "Accumulation Fund") consisting in part of contributions of parents of secondary students from which the initial loans would be made, purchased or guarantied. The incentives for parents to contribute to the Accumulation Fund are not completely thought out, and even if the response if very positive, it will be several years before the fund will be large enough to provide a reliable source of student loan funds. It may be that the fund will have to be seeded by budget moneys or the sale of securities backed by the NBU, or both. And it is possible that, at least initially, the fund will be the source of loans or loan purchases, not simply a reserve for the payment of losses.

As a source of loan funds, an alternative would be to convince commercial banks to make student loans. The program being proposed will offer loans that average $1,500 per student to 1 million students. The demand is impossible to predict. If the state student loan program is any indication, only a small fraction of eligible students are likely to require assistance. But, the country must be prepared to be surprised. Ukrainian banks have that kind of money to lend, more easily than the government treasury. And having banks make the loans has other benefits for the economy: students establish relationships with banks; and banks will compete to improve their consumer loan delivery, collection and administration.

Commercial banks in Ukraine are not currently comfortable with making long-term loans secured by the expectation that the borrower will have sufficient income at the end of school to repay the loan. In order to induce banks to make long-term student loans, the NBU can enter into long term purchase commitments with banks, preserving the liquidity of a short term loan without making the loan instrument a short term one. This purchase commitment would obviate the need for a government guaranty: if the bank could sell the loans at any time, then the bank could sell delinquent loans when the effort to collect them was no longer cost-effective.

Action Item: Develop a Loan Collection Methodology

Another challenge is the absence of a student loan collection methodology. NBU proposed that banks might be engaged to administer loans, but loan administration is not a line of business in which they are currently engaged. Defining what tasks the banks should do and establishing a reasonable price for their services will be difficult because there is little comparable activity to provide a cost model. The procedures for and costs of collecting non-student loans are significantly different, since those loans typically do not have the kind of flexible repayment plans that make student loans unique. The procedures and costs of collecting student loans in other countries provide some insights, but the student loan experiences in other countries vary widely depending on the local culture and legal heritage.

An alternative may be to establish a loan administration office within the NBU to perform the administrative function, simultaneously assessing the effectiveness of various collection procedures and assembling cost information on this dimension of the program. Wherever the function is housed, the methodology must address some difficult issues, such as collecting from people who have left the country and enforcing loans in a judicial system that is traditionally hostile to creditors.

If the NBU gets the commercial banks to make student loans, a lesser degree of control over collection methodology is required. Banks must be encouraged to make diligent attempts to collect loans: they should not be permitted to sell loans that are delinquent and that have not had some diligent collection effort. What steps must be done is something that should be negotiated between the NBU and the bank in the long term purchase commitment.

Action Item: Ensure Students' Willingness to Repay

Finally, the NBU should require participating schools, and, if appropriate, participating banks, to conduct an education program at the time the loan is made. No students and few families have experience with credit in Ukraine, and the country has experienced a number of notorious loan program failures. If students understand how the loan program works, including the social values of repaying in order to recycle funds for their younger brothers and sisters and to enhance the reputation of their school, their willingness to repay will be enhanced. Parents or other loan guarantors should be required to attend the program also.

In addition to these larger challenges, there are many details of a student loan program to be worked out, some of which are discussed below. The country has a program whereby the government subsidizes agricultural loans made by banks to individual farmers, which should be studied for lessons learned and work effort that can be reused.

Methodology and Acknowledgements

This paper is based largely on interviews with officials in the government, higher education and banking communities conducted over a 2-week period in mid 2004 and a limited review of related literature.

The author expresses deep gratitude to the following persons who expressed their views and provided information in conjunction with this analysis.

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Scope

While of significant importance, this analysis does not address many issues that are critical to the overall growth of higher education in Ukraine. There is currently a healthy public debate about the effectiveness of the system of higher education in providing the skills demanded by the economy and the proper role of private institutions. This paper also does not address financing education of Ukrainian students wishing to study in other countries or the impact of tax laws on higher education, and makes no recommendations for resolving the administrative issues with the current state student loan program.

Current System of Higher Education

An understanding of the current system of higher education in Ukraine necessarily starts with an understanding of the country's heritage of central control. Under the Soviet system, higher education, like primary and secondary education, was exclusively the responsibility of the government, both national and regional. Each year, the government would determine, by occupational category, what the country's (or region's) needs were for labor educated in each occupation. Then, based on that determination, each university was assigned a number of students to enroll in each major field of study. The costs of faculty and facilities were paid out of the national and regional budgets.

The institutions that existed in Ukraine prior to independence make up its public institutions of today. The "national" universities are those that are completely supported by the national government; and "regional" universities are supported, at least in part, from regional government budgets.

In addition, since the beginning of the 1990's, a number of private universities have been established and accredited. Today 11.9% of students are enrolled in private institutions.

In both public and private universities, the number of students who may be admitted to each of 16 fields of study[5] is set by the institution's license: universities may not simply recruit more students in order to take in more revenue. Likewise, in both public and private universities, the specific fields of study the institution may offer are limited to those approved by the government: universities may not add or drop programs of study based on student or labor market demand.

Although Ukrainians, officially and privately, will say that the quality of instruction in its universities is not on a par with that of the United States and Western countries, there are no objective measures to confirm or contradict that view. As one vote of public confidence in the system, the percentage of people applying for tertiary education is rising rapidly. In Academic Year 2003-2004, there were a total of 2,436,700 students: 593,000 studying at Levels I and II ("junior college" level) and 1,844,000 studying at universities offering Levels III and IV (bachelors) or higher degrees. This is a rate of 512 students per 10,000 of population, a number that has been rising over the last decade even though, according to World Bank studies, 1/3 of Ukrainians are living at or below poverty level. Nearly 2/3 of the students attend full time during the daytime; the remainder are part-time, evening students and, increasingly, distance or correspondence students who live in rural areas. Nearly 90% of those who enroll graduate: it is rare for a student to leave school for academic or financial reasons.

The increase in enrollment in tertiary education is even more notable because Ukraine has a declining number of high school students.[6] Some of the enrollment is people changing jobs, and that segment of the student body is expected to rise, but the bulk of students are traditional students, applying immediately upon completion of secondary school, attending full time and living on campus.

There is no tradition of alumni donations to their alma maters, nor do schools have endowments or run capital campaigns[7].

Public Institutions

Of the 1,007 universities in Ukraine, 819 are called public institutions but they are not financed or managed like public institutions in the United States. For Americans, the

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[5] The fields of study and the distribution of students among them are set out in Exhibit 2.

[6] According to the United States Census Bureau, between 1989 and 1994, marriages in Ukraine fell by 19 % and births by 25%. A more refined measure, total fertility rate—the number of children born per woman during child-bearing years --shows comparable decline. The total fertility rate was 1.9 children in 1989-90; it decreased to 1.4 children by 1994-95. A total fertility rate of 2.2 generally is needed to maintain population at current levels. http://www.census.gov/ipc/www/ebspr98a.html.

[7] As with any rule there is an exception. The EERC has received major funding from the World Bank, foundations, the national and foreign governments and local businesses in order to implement a masters program in economic theory.

closest analogy is our military academies, whose operating costs are paid completely out of federal funds; students are given money to cover their personal expenses and are expected to serve in the military upon graduation. But unlike U.S. military academies, public universities in Ukraine also admit students who pay for their cost of education.

Approximately half of the students enrolled at public institutions are state order students, who are educated entirely at public expense, 70% out of the national budget and the remaining 30% (and growing) out of regional government budgets. In addition to having to pay no tuition, state order students receive a stipend to cover living expenses.[8] Upon completion of studies, the government places state order students in job positions in the public sector or a state-owned industry, although students are not required to seek an assigned position. The number of state order students has been stable for the last 7 years, although the percentage of state order students is dropping since increases in enrollment are almost all being taken up by the private institutions. There does not appear to be a consensus within the Ministries today about the future number or proportion of state order to regular students.

Although state order students are supposed to work following graduation in public sector or state-industry jobs, nearly half decline to do so. One reason why students avoid these jobs is, presumably, because they pay substantially lower wages than private employment (although public sector employees receive better pensions than corporate retirees).[9] This is a particular problem for the country in the area of teaching, where there are a large number of unfilled positions. Even among graduates that do take public sector positions, a substantial number leave those positions after a few years, particularly in Kyiv where the commercial sector is growing rapidly and providing well-paying, challenging job options.

Another likely reason for low job placement rates in certain occupational fields, like engineering, is that the number of students trained is based on estimates of the demand for those skills made 5 or more years before the current graduating class entered the job market, and jobs in those specialties simply are not there today. Since that time, a number of state-owned industries have been privatized,[10] so the number of jobs to be filled in those sectors is dropping.

Also attending public university are students who are not supported by the government, the "regular students." Full-time regular students at public universities pay tuition ranging from $600-2,500 USD, depending on the school's reputation and location and on the popularity of the occupational field of study. Law, foreign language and information technology—the fields in high demand in the private sector4—are currently among the most popular, and therefore the most expensive. Tuition is determined by the university, but once fixed, may not change during the student's enrollment. Regular

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[8] Schools provide housing and food at deep discounts, but they are not free.
[9] There is currently an investigation into allegations that, instead of placing students into jobs, schools are requiring state order students to find their own jobs before they will be permitted to graduate. If true, the rate of real job placement may be even lower than official numbers suggest.
[10] Today, 80% of companies are now private. This figure does not take into account the recent sale of Ukraine's rolled steel factory.

students attend the same classes and are completely integrated with their classmates who pay nothing.

Obviously students at public institutions would prefer to be state order students and competition for state order student positions is fierce. Nominally, students take examinations to determine their aptitude, and those with the best scores get the state order positions. But in reality, state order positions in the most popular fields are spoken for before the examinations are administered. People of influence and people who can pay get admissions officials to put their sons and daughters on the roster of students permitted to take state order student examinations.[11]

Public institutions, like government agencies everywhere, are permitted to spend money only where specifically authorized. Public institutions also do not have independent revenues.

Private Institutions

As noted above, private universities are relatively new to Ukraine and the government provides no support for them. Under Ukrainian tax laws, private institutions are treated like commercial enterprises, which obviously increases their operating costs in comparison to public institutions offering comparable education.

Private universities, like public ones, are licensed to enroll a specific number of students in each approved area of study. The Ministry of Education appoints the rectors, just as if they were public universities. However, private universities are free to add faculty and to accept outside consulting contracts. Private universities also may augment their income by publishing. Unlike public universities, private universities provide job placement services for their students.

Of the 188 private universities, 104 are licensed to offer bachelors degrees or higher. Of the remaining 84 junior institutions, several have applied for permission to offer higher degrees. Getting accredited for higher level studies is a challenge, since full professors work in already accredited institutions, and junior colleges have to attract visiting faculty or candidates for professional degrees to meet the accreditation requirements.

Current System of Higher Education Finance

In the years since Ukrainian independence, the financing of higher education has changed dramatically. Today it is more complex, retaining at one time remnants of the Soviet system and adaptations of the U.S. system.

[11] Students seeking their second degree are ineligible for state order positions.

In the most recent Fiscal Year, Ukraine appropriated approximately $4 billion for public higher education.[12] Of that, $2 billion is intended to cover faculty salaries and certain essential operating costs. The second $2 billion consists of tuition payments from regular students returned to the university and is designated for the payment of stipends to state order students and the balance of the institution's operating costs. Several years ago, the country got behind in paying the schools money for stipends, precipitating a student strike.

It is common for Ukrainian students to work part time to defray expenses, in the case of state order students, to supplement their stipends. It is also common for universities to provide housing free or at substantial subsidies to students coming from out of town and to provide subsidized food services.

University officials complain that actual budget appropriations for state order students do not cover their pro rata share, so regular students' tuitions must be larger to cover essential operating expenses. For example, at Kyiv National Trade and Economic University, for example, the funds appropriated for state-supported students cover only 30% of the school's actual costs. Accordingly, in order to meet essential expenses, tuition paid by the 40% of regular students at that school must be twice their pro rata share of the burden.

Tuitions at private institutions are generally comparable to public institutions except those that are offering degrees that are recognized in Europe and the United States. The primary reason for the higher costs in the latter case, of course, is that obtaining faculty with the credentials required for western accreditation requires these institutions to import faculty from other countries where faculty salaries are substantially higher than those employed by the government of Ukraine. The Economic Education and Research Consortium (EERC), which is actually an autonomous branch of the prestigious Kyiv School of Economics at the National University, Kyiv-Mohyla Academy, is permitted to charge a tuition of $2,500 (one of the highest in the country), but its cost of operations is $12,500/student/year. So far, major donors within and without Ukraine have covered the $10,000/student gap.

Bank Involvement

Banks are currently not a factor in Ukrainian higher education finance. Although some banks are currently attempting to make a market in so-called student loans, as discussed below, those loans are really loans to creditworthy parents. Indeed, banks are still relatively new to the practice of making loans to individuals: mortgage loans have been authorized only for 5 years; loans for the purchase of automobiles are newer; and

[12] One expert estimates that, in addition to this $4 billion in appropriations, universities take in an additional $1 billion in bribes. Bribes are paid almost everywhere there is competition, from admission to graduation. In a survey conducted by the student magazine *I am a Student*, 90% of students said they thought education in Ukraine was corrupt (meaning public employees use their positions for material benefit), although only 55% admitted they had personally experienced corruption. The scale of corruption is substantiated by studies that compare declared wages with actually spending by residents of Ukraine. Obviously, graft is widely tolerated to excuse having to increase public employee compensation.

the notion of buying goods such as home appliances on credit is only a 21st century phenomenon.

Banks' reluctance to make consumer loans also has its roots in Ukraine's communist history. The communist courts were reluctant to deprive a debtor of his house or confiscate essential wages as a penalty for non-payment of a debt if doing so would cause a hardship on the family. Therefore, if a person borrowed money (or guaranteed the loan of another) and was unable to pay, it was highly unlikely the bank would have recourse. The new mortgage law authorizes the sale of a home or apartment to satisfy a mortgage debt, but few, if any, foreclosures have occurred. As a result, banks remain cautious to lend only to people who have substantial assets, who can secure a guarantor with substantial assets, and who do not have infants or elderly relatives in the household.

Current Student Loan Programs

Ukraine has a limited amount of experience with student loans to date. The government runs a small direct loan program; and three commercial banks have entered the field.[13] These programs offer insight into how a new loan program will fare.

Ukrainian State Student Loan Program

The government launched a state student loan program four years ago under which approximately 4,000 students (less than 2% of all students) have received financial assistance. The policy objective of the program is to assist financially vulnerable students who have good academic potential: students who nearly qualified for state order positions and whose families are unable to support them as regular students. The program was launched without sufficient preparation, causing confusion among universities and students, and only some of the bugs have been worked out. In Academic Year 2003-04, $5-10 million was set aside for student loans: for 2004-05, that amount was increased to $20 million (0.5% of the total Ukrainian budget for higher education). In Academic Year 2003-04, a few schools reported excess demand for loans; yet, according to the Ministry of Education, 90% of the schools had fewer students apply than the school was authorized to offer.

In the first year of the program, 20-30% of the student loan applicants were denied, largely because of confusion over eligibility requirements or low examination scores. Last Academic Year, almost all applications were approved.

Pursuant to the program, universities enter into agreements with the Ministry of Education whereby they agree to redistribute funds to students in accordance with the student loan law and remit student loan repayments to the government. The Ministry then authorizes each school to offer loans to a specific number of students, based on the number the school requested and the availability of budget funds. Universities then

[13] The Soros Foundation may also offer, or once have offered, a student loan to Eastern European students attending graduate schools of business in which Ukrainian students are eligible to participate. Information about such a program needs to be garnered.

identify which students are eligible and direct the student to complete the loan application and submit it to the Ministry. The Minister of Education makes the final determination of which students are eligible and notifies the school that he or she may be admitted. Unfortunately the funds to support that student may not accompany the admission order.

Students approved for loans execute agreements with the university in which the university agrees to deliver education and the student agrees to repay the loan amount, plus interest, or provide documentation supporting loan discharge

The state student loan carries a 3% interest rate and is repayable in 15 annual installments. If the student withdraws or fails to make academic progress, he must begin repayment in 3 months; students who graduate are given a grace period of 12 months after they receive their job placement. Graduates who work 5 years teaching in remote areas of the country, who die or who become totally disabled are excused from repaying their loans. Deferments are provided for (a) military service and (b) 3 years to care for an infant. Failure to repay carries a penalty of double the amount borrowed at the market rate of interest.

The basic eligibility criteria are: the student is younger than 28 years of age and achieved above a minimum score on the entrance examination administered to state order students. (The precise minimum score is set by each school for each discipline. If the student is younger than 18, a parent must apply for the loan.) Since few students at private schools, and no advanced degree candidates, took the entrance exam for state order positions, virtually all loan recipients are in public schools.

There are a few other categories of students who may receive state student loans. For example, regional governments, instead of the federal government, sponsors 30% of the student loans. Regional governments may authorize loans to the top high school students in their particular region or offer loan forgiveness in exchange for the student's commitment to work in the region upon graduation. Again, there appears to be no central source of information about these variations on the theme.

The few state student loans actually made to students attending private universities are most likely to orphans or other special needs students or to young people who have entered into a post-employment job agreement with a regional government.

Since the university is apparently required to repay student loans to the government, the contract structure of the state student loan program seems to put the university in the position of a guarantor for the student.[14] However, since universities do not have revenue from which to repay the government, this places them in an impossible position. For a public university, as discussed above, there is no source of revenue from which to make the loan repayment, nor authority to spend appropriated funds to do so. This "catch 22," together with low student interest and complex application requirements, has resulted in some public universities declining to participate in the program.

[14] As discussed below, few loans are due yet. These ambiguities will have to be worked out soon.

Another operational complication of the current state student loan program is that schools do not know until late in the academic cycle how much money will be available to lend. Since regular students are not admitted until they have paid tuition, these most vulnerable students may be discouraged from competing for admission in the first place.

The administration of the state student loan program has a rocky history. Initially it was contemplated that banks would disburse and administer the loans. Since commercial banks are not permitted to administer budget money, one of the state banks, Aval, was enlisted to be the administrator. However, the government would not give that bank assurance that it would not be responsible for operational issues or be taxed on the loan payments. One critical operational concern was that, if the government were not timely delivering the loan funds to the bank, the bank was concerned that it would be obligated to fund loans from its own resources. Since commercial loan rates were then 10 times the student loan rate, the bank was unwilling to do that without assurances that it would be made whole.

When discussions with Aval broke down, the student loan legislation was amended so the Treasury now sends the money to the school. But the administrative responsibilities are far from resolved: no one is currently responsible for collecting the loans. The Ministry of Education believes only a bank can administer the program adequately and discussions with NBU are ongoing.

Of the 4,000 state student loans made to date, 500 have entered the repayment phase and approximately 20% are delinquent (30 days past due).[15] However, as a consequence of the administrative issues, there is confusion as to whom the borrowers are to pay and no one knows how many students have been placed in rural teaching jobs, joined the military or had babies. Public universities do not track their alumni and may have no account into which to deposit the money if a student should make a payment. So some schools may have yet to instruct borrowers to commence repayment.

Commercial Bank Student loan Programs

Consumer lending in Ukraine is relatively new but growing in popularity. Borrowing money to finance apartments and cars is becoming widely accepted, as well as financing major appliances. Interest rates in these programs are comparable to the rates charged in the commercial student loan programs, although longer terms are offered for mortgages (12 years) and auto loans (5 years).

Three banks in Ukraine are offering student loans, but the number of students who have benefited is very small. Private student loans, although made in the student's name, are nearly always secured by parents' assets. The loans are typically short term—no more than 36 months—and bear interest at a rate of 15-20%.[16] Students have to provide

[15] According to the promissory note used by the National University "Kyiv Mohyla Academy," loan repayments are due only annually, on the last day of December. (*See* Exhibit 3 at 6.1.) Therefore, a borrower who is past due, in July, which is when the interviews for this report were conducted, would have been 6 months past due. This suggests some institutions have discretion in the terms of the loan.

[16] Loans made and repaid in U.S. Dollars bear interest at 9%.

evidence of enrollment, have jobs and purchase insurance on the collateral (the premium for which is typically 2% of the loan amount). Because of the short terms, most student loans are, in fact, repaid by the parents.

Weaknesses of Current System

Ukraine has one of the highest literacy rates in the world, which is a testament to its belief in and support for education. Competition for post-secondary education also motivates students to work hard through high school and ensures that universities continue to attract well prepared candidates for admission. However, universities suffer from low faculty salaries, which affect recruitment and retention, and dated facilities. And the system of public financing and allocating enrollment destroys almost all incentive to improve either.

There is not universal agreement among the Ukrainian ministries and universities as to what the policy objectives are to be addressed by a new student loan scheme (except, of course, to support the President). The Ministry of Education is focused largely on providing opportunities for special needs students, although they appreciate that a broad student loan scheme will give students more freedom to study in their preferred field. The private universities are clearly focused on increasing access to their institutions for bright, motivated middle class students. Banks, being commercial enterprises, must be wary about financial risks, but would be happy to establish business relationships with students who are likely to be the leaders and customers of the future.

Cross-subsidization by Regular Public School Students

One weakness of the current system of higher education finance is that is results in regular students subsidizing the cost of educating state order students and first year students subsidizing the cost of educating returning students. The situation at Kyiv National Trade and Economic University illustrates the problem. (See *infra* at page 12.) In order not to burden regular students more than is already the case, schools strive to live within the budgets they are given, which means dated facilities, under investment in technology and retraining and crowded dormitories.

Limitations on Access to Private Institutions

In the case of private universities, the lack of student loans has an obvious impact on access. Only students from families with substantial resources can pay the tuition (or qualify for so-called private student loans).

National Bank of Ukraine Proposal

In response to the President's challenge, NBU established a work group to develop a new student loan proposal. That work group devised a scheme that has the following components.

1. COST SHARING BY STATE ORDER STUDENTS. NBU proposes to initiate a policy of charging some portion of the cost of their attendance to some state order students. Students in professions that are only employed by the government, military, police, perhaps teachers and doctors, would continue to be educated in the traditional manner. But a portion of the state order students specializing in most fields would be required to pay a small percentage, perhaps 20%, of the cost of their education. Full state order positions would be awarded to those whose scores on admissions exams were highest; partial state order students would be awarded to those whose scores were in the middle range; and those who failed to meet the minimum score would be allowed to enroll as a regular student. The exact ratio of full to partial state order students has not been determined.

2. NEW STUDENT LOAN PROGRAM. NBU would launch a new loan program, supplemental to the current state student loan program, to address the needs of regular and partial state order students, including students attending private universities. State student loans, with their highly subsidized interest rate and forgiveness features, could be retained for students with special needs. The new loans would be made by commercial banks and be partially subsidized and fully guaranteed by the government, much like the U.S. Stafford student loan program.

3. ACCUMULATION FUND. The NBU would establish an Accumulation (Reserve) Fund to provide funds from which to pay guaranty claims.

4. LIQUIDITY FACILITY. The NBU would establish a new institution or undertake to serve as a secondary market for student loans. Capital for purchasing loans would be raised by selling securities in the Ukrainian market.

Accumulation Fund

The Accumulation Fund would be responsible for maintaining data on borrowers and making reports to the credit bureau if and when the credit bureau law is implemented. It is contemplated that the Fund will have regional offices to be conveniently located to universities outside the capital city of Kyiv.

The Accumulation Fund would be built from contributions from the families of high school students, a tax-advantaged savings plan. Parents would be permitted to contribute, and deduct from taxable income, up to $1,000 UAH per year to the fund, and their deposits would be protected from inflation (which in 2003 was 9%). When the child was admitted to school, the deposits would be paid to the university to defray tuition; and any money not needed (say, for example if the child qualified for a state order position), would be returned (net of the deferred tax)[17] or could be transferred to another tax-favored investment. It is not clear how participation in the Fund would impact eligibility for a student loan.

Liquidity Facility

The fourth part of the NBU proposal is to establish a liquidity facility to provide funding for guaranty payments and, if necessary, to provide a secondary market for student loans. This institution would set terms and conditions for loans it would purchase, thereby standardizing the terms and conditions of student loans.

Although the cost of capital in Ukraine is relatively high, deposits are accumulating in the economy. Capitalism has brought wealth in many sectors, and savings are building. In addition, the country is about to launch a pension savings plan that will generate substantial funds for investment. NBU is confident that it will be able to issue securities.

Critique of NBU Proposal

The NBU proposal has not been endorsed by the Ministries, and there are strong differences among them as to the need for or purpose of a new student loan program. The Ministry of Finance expressed the opinion 4-5 years ago that a student loan program was not needed, and it has not been determined whether this view still prevails. The Ministry of Economy is of the view that each sector—agriculture, engineering, business, etc.—should work with its corresponding bank to address the needs of that sector. In addition, the Ministry of Economy proposes that the government should subsidize the interest cost of student loans, and that amount of the subsidy vary depending on the demand for graduates in the students' chosen field of study. That way, students would be encouraged to enroll in programs leading to those skills in high demand by the economy. Finally, the Ministry of Education has expressed the view that its priority is to address the special needs students, the orphans, the disabled, etc., and that loans are not the best option for this population.

An assessment of the effectiveness of the NBU proposal is complicated by this lack of consensus on goals. So long as universities are not permitted to increase the number of enrolled students or to increase the price of attendance, the loan program serves only the purpose of shifting the cost of education from the government to the public, without any obvious benefit to the public. It is as likely that a student loan program will bring about a decrease in public university enrollment by the poor and middle income without an offsetting increase in private university enrollment.

[17] Since payments for tuition are also deductible from income, parents who contribute to the Accumulation Fund only affect the timing of their tax deduction. Current income tax rate is 13%.

Loan Program

The NBU work group has not yet formulated ideas about loan terms and conditions and processing issues, although those are critical to developing work flow analyses of how the program might succeed. Based simply on experience elsewhere within and without Ukraine, the following parameters are suggested:

1. Loans should be made for no more than the amount of tuition and mandatory fees.

2. Loans should not be made to students in their first year of school. Loans should also not be made to students studying in other countries or should be made on less favorable terms, since students studying abroad are more likely to live abroad after graduation and there is a higher cost to collect money across borders.

3. Loans should be made without inquiry into the student's or his family's financial situation, so long as the student is making satisfactory academic progress. It is difficult to get objective information about family income and assets in Ukraine, and limiting loans to those with demonstrated financial need introduces opportunities for graft. It is apparently also difficult to get objective information about academic progress, but clearly it is not prudent to make a loan to a person on the verge of dropping out, so an effort to assess academic progress should be made.

4. Loans should be guarantied by the parents, if living. Again, there should be no inquiry into the family's income or assets; the primary purpose of the guaranty is to help to maintain contact with the student borrower and enlist family assistance in cases of delinquency.

5. Schools should be required, as a condition of participating in the loan program, to conduct a program for student borrowers and their parents (or, in the case of married students, their spouses) describing how the loan program works, including not only their personal loans but also the macroeconomics of the program.

6. Schools should also be required to collect and publish to potential students information about the careers of recent graduates, including expected salaries for different lines of work. If the information suggests that students in certain careers will be unable to repay loans, then loans should not be made to students in those fields of study, or the total amount borrowed should be limited.

7. Students should be expected to make interest payments during the time they are enrolled and should be expected to begin principal repayments no more than 6 months following graduation. At the same time, lenders should

develop flexible repayment programs to take into account the financial vulnerability of young people due to things such as post-graduate enrollment, starting a family, illness and loss of employment.

8. The government should subsidize the interest rate on the loan so that the lender receives a market rate of interest, but the borrower pays no more than the rate of inflation.

9. The government should purchase any loan from a lender at par at any time, in effect providing both a guaranty and a secondary market function. The only restriction should be that the lender followed reasonable steps to originate and collect the loan and made required data reports as set forth in rules published by the government.

Accumulation Fund

Although it is not impossible that an Accumulation Fund could be established with parental contributions, the job of explaining it and promoting it to target investors is monumental. Public confidence in the government as a place to put family savings remains weak in the wake of the failure of the Savings Bank, another government institution.

A second concern with establishing the Accumulation Fund from parents' savings is that it puts the government in competition with commercial banks for consumer deposits. This is not a step to be taken lightly, particularly if the NBU wants these same banks to participate as partners in the new student loan program.

Student Loan Administration

The NBU has focused its thoughts to date on the establishment of the institutions necessary to administer a student loan program, but there remains to be considered the huge issue of how to administer a student loan program.

There are only two fundamental reasons why borrowers do not repay their student loans: they do not have the means or they do not believe it is required.

There has been almost no work to establish whether students will have the means to repay student loans out of future wages. Neither the public universities nor the government has undertaken any systematic study of wages of graduates. Yet, there are a number of indicators that wages, at least in Kyiv and in some occupations, are sufficient to repay student loans. To a visitor, the economy appears vibrant: one sees buildings under construction, casinos, restaurants, high-end merchandise and late model automobiles. Research conducted by a few private universities and the Consortium for Enhancement of Ukrainian Management Education, which is promoting changing teaching methods in business education programs, shows positive results. One example is a study by EERC. EERC has 242 masters degree graduates in its 7-year history, of which 40% are currently in doctoral programs in 44 schools in 7 countries. EERC has collected employment and salary information from the remaining 60% of its graduates who are now in the labor force. Unfortunately, without good data on the real cost of living, it is risky to draw conclusions from the EERC data, but most of the EERC graduates' salaries appear sufficient to support loan repayment.

There has also been almost no work by NBU to establish repayment plans, pursuit plans for delinquent loans, procedures to track debtors who move without notice and rewards for timely payment.

One collection tool that has been very useful in the United States and is being copied in Ukraine and elsewhere is credit bureau reporting. The NBU has raised the idea of establishing a database of students who are in arrears in payment.[18] The credit bureau makes this database unnecessary and has the advantage of recognizing people who pay timely as well has exposing those who do not. In a credit based economy, where lending decisions are based on objective data instead of personal relationships, people who pay their student loans timely are favored for future loans, rentals and even employment opportunities.

Similarly, there has been no work to establish whether students are willing to repay. Certainly in a country that has such a limited experience with consumer lending, a significant investment in consumer education is necessary.

Public Sector Professions

The state student loan program should be retained but its scope changed to focus on—

?? Special needs students, such as orphans and handicapped students[19], adults returning to school for retraining and gifted students from poor, rural areas of the country.

?? Special categories of students, such as valedictorians (called gold medal winners), veterans or athletes.[20]

?? Students studying for public sector professions, particularly the military, perhaps doctors or teachers.

Conclusion

This paper has set forth four key steps to resolve remaining conceptual issues with the NBU proposal for a student loan program:

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[18] See Task order for USAID program advisor at section 1.6.

[19] Ukraine has a surprising number of orphans, 12.9% of the tertiary education enrollment. Three percent of students (7,917) are disabled.

1. Developing a national consensus on the purpose of the program and establishing parameters for assessing progress in meeting the goal;
2. Establishing procedures for collecting and publicizing information on the economic benefits of higher education;
3. Establishing procedures for recovering student loan payments; and
4. Establishing procedures for publicizing the benefits of a healthy student loan program.

These tasks, once accomplished, will lay a firm foundation for a financially sound student loan program.

Exhibit 1

National Bank of Ukraine Student Loan Program Diagram

[Insert NBU Diagram]

Exhibit 2

Higher Education Graduates by Area of Expertise
Academic Year 2001-02

Area of Expertise	Total	Percent State Order
Education	31,301	64
Culture and Art	4,587	70
Humanitarian Sciences	18,721	63
Social Sciences	3,581	44
Economics, Commerce and Entrepreneurship	93,073	35
Law	25,922	42
Natural Sciences	13,350	80
Mathematics and Information Science	8,088	80
Engineering	80,223	75
Transportation	6,245	78
Medicine	10,110	73
Architecture	982	71
Agriculture, Forestry and Fishery	9,347	79
Military Sciences	3,875	88
Public Administration	1,001	61
National Security	24	0
Other	470	46
Total	310,900	58

Exhibit 3

Student Loan Promissory Note

APPROVED
The Order of the Ministry of Education and Science of Ukraine
No. 508 of July 31, 2003

AGREEMENT No. 1
On granting a special preferential state education credit

Kiev **September __, 2003**

[Insert name of Educational Institution]

Represented by *President [insert President's name]* acting on the bases if the statue of the higher educational institution (hereinafter referred to as the Educational Institution), and citizen of Ukraine *[insert Borrower's name]* (hereinafter referred to as the Borrower), (hereinafter together referred to as the Parties) have concluded this agreement on the following.

1. Subje ct of the Agreement

The Educational Institution in accordance with the Procedure of granting special preferential credits for receiving higher education, approved by the Resolution of the Cabinet of Ministers of Ukraine No. 916 of June 16, 2003, shall grant to the Borrower a special preferential state credit for receiving a Bachelor's degree in [insert field of study] in the Educational Institution at the cost of the state budget in the amount of UAH 11,000 for an academic year and UAH [insert amount] for the entire term of studies.

2. Obligations of the Educational Institution

The Educational Institution shall be under the obligation to:

2.1. Take the Borrower for studies to the Educational Institution with issuance of a corresponding order;

2.2. Ensure organization of the study process in the Educational Institution for the Borrower to successfully receive the selected educational and qualification degree;

2.3. Take measures provided for by the educational legislation as to the Borrower's progress in studies;

2.4. Issue a state standard diploma upon the completion of the studies by the Borrower;

2.5. Familiarize the Borrower with the statute of the Educational Institution, other norms and regulations, established by legislation and effective in the Educational Institution;

2.6. In the event of early termination of the present Agreement inform the Borrower in writing on the used amount of credit, the interest to be repaid by the Borrower, as well as the date of maturity.

3. Obligations of the Borrower

During his/her studies in the Educational Institution the Borrower shall be under the obligation to:

3.1. Observe laws, statutes, regulations and other norms effective in the Educational Institution;

3.2. Comply wit the study schedule and the curriculum requirements;

3.3. Within 15 years repay the principal granted by the Educational Institution and 3% of the annual interest for using the credit upon completion of the studies starting from the twelfth month, and in the even of expulsion of the Borrower from the Educational Institution, starting from the third month from the expulsion;

3.4. Should there be circumstances being a legal ground relieving the Borrower from credit repayment, provide the Educational Institution with a relevant document confirming such circumstances on an annual basis upon completion of studies;

3.5. Inform the Educational Institution of a change of the place of residence or employment upon completion of studies.

4. Rights of the Educational Institution

The Educational Institution shall have the right to:

4.1. Terminate the present Agreement ahead of time and expel the Borrower from the Educational Institution in the even of failure to fulfill the curriculum, as well as in other cases provided by legislation;

4.2. Charge the principal and the interest on the Borrower through the legal procedure in the event the Borrower avoids credit repayment.

5. Rights of the Borrower

The Borrower shall have the right to:

5.1. Terminate the present Agreement ahead of time and discharge his/her obligations as to the credit repayment as well as the interest;

5.2. Prolong the term of the Agreement for the time of an academic leave;

5.3. Repay the principal and the interest ahead of time determined by the present Agreement;

5.4 Repay the credit at the cost of a third person.

6. Credit Repayment Procedure

6.1. The Borrower shall repay his/her credit in the amount of USA [11,000] and the interest in the amount of USA [4,950] through cash or non-cash payment to the banking account of the Educational Institution by December 31 with annual payment of 1/15 of the total amount of the received credit and the interest from June 30, 2007 to June 30, 2021.

6.2. The Borrower shall be entitled to repay the principal and the interest on a monthly basis.

6.3 The date of credit repayment shall be extended for the term of:

- the Borrower's army service for a fixed period;
- child care leave until the child reaches the age of 3.

6.4. The principal and the interest shall not be repaid in the event of:

- the Borrower's employment with a state or municipal institution or establishment in the rural area for at last 5 years upon graduation;
- The Borrower's death or assessment of his/her disability of the 1st group.

7. Liabilities of the Parties

7.1. The parties shall be held liable in accordance with legislation for non-fulfillment or improper fulfillment of obligations under the present Agreement.

7.2. Should the Borrower avoid the principal or interest repayment, he/she shall be charged a fine in the size of double the interest rate of the National Bank of Ukraine of the amount not repaid in due time.

8. Term of the Agreement

8.1. This Agreement shall enter into force from the day it is signed by the Parties and shall be valid by the date of repayment of the principal amount of credit and the interest.

8.2. The Agreement may be prolonged for the term of circumstances set forth in clause 6.3.

The present Agreement is made in three copies, each of which has equal legal force.

Location and Details of the Parties

The Educational Institution	The Borrower
______________________________	______________________________
______________________________	______________________________
______________________________	______________________________
______________________________	______________________________

Glossary and Index of Acronyms

Cost of Attendance	The total cost of attending a university, including tuition and living expense (each as defined herein).
University	Any institution of higher education. In Ukraine, such institutions may be academies, conservatories, institutes or colleges, as well as universities.
NBU	National Bank of Ukraine
Living expense	The direct expense incurred by a student to live while attending a university, primarily food and personal expenses.
Loan	The Ukrainian and Russian terms for loan are generally translated as "credit" instead of "loan." "Loan" in English is the extension of credit under a specific agreement to repay; whereas "credit" can have a broader meaning.
Monetary amounts	All monetary amounts are in U.S. dollars unless designated UAH (Ukrainian hryvna).
Regular student	A student who pays his or her own cost of attendance.
State order student	A student whose cost of attendance is paid out of the national budget appropriations. Also known as "budget student."
Tuition	The portion of the cost of attendance imposed by the university: cost of enrollment, books and mandatory fees. For students living in dormitories, the cost of housing is included in the term as well.