

**PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: AB3303

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| Project Name | Colombia- SCALING –UP STUDENT LOANS TO PROMOTE EQUITABLE ACCESS PROJECT |
| Region | LATIN AMERICA AND CARIBBEAN |
| Sector | Tertiary education (95%);Secondary education (5%) |
| Project ID | P105164 |
| Borrower(s) | ICETEX - GOVERNMENT OF COLOMBIA |
| Implementing Agency | ICETEX |
| Environment Category | <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined) |
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1. Key development issues and rationale for Bank involvement

Colombia needs to improve its competitiveness and sustain recent improvements in growth rates. After the severe crisis that hit in Colombia in 1999 and a following slow period of recovery, the Colombian economy is finally growing at a high rate (6.8 percent in 2006). The increase in economic growth has helped reduce poverty levels, but there remains significant space for improvements in competitiveness, growth and poverty reduction. In order to sustain high growth rates in the medium and long-run, Colombia will need to accelerate the process of economic diversification and encourage firms to move into higher value-added production. The policy options to achieve these objectives, and thus increase competitiveness and growth, may be many, including investments in infrastructure, institutional improvements, and improving access to finance, among others. However, evidence suggests that a key component for innovation, competitiveness and growth is the formation of human capital and access to highly skilled workers, which is the focus of this proposed project.

Improving access to highly skilled labor contributes to increasing labor force productivity and the competitiveness of the Colombian economy. Most theories of economic growth highlight the key role of human capital, through improvements in innovation, labor productivity and/or technological change. A reflection of the contribution of tertiary education to economic growth lies in the returns to education. Workers with tertiary education tend to earn higher salaries, reflecting, at least in part, their higher productivity. In Colombia, private returns to tertiary education have been rising; a worker with tertiary education now earns an average of 2.4 times the salary of a worker with secondary schooling. In light of new economic opportunities arising from new trade agreements and increased globalization, the importance of highly skilled labor may prove even more important. Furthermore, there is an underutilization of talent due to increasing inequities in enrollment and access to quality tertiary education, a common feature in the region.

Demand for tertiary education has increased significantly in recent years, and most of the demand has been serviced by the private sector. With a tertiary gross enrollment rate of more than 25 percent, Colombia has rapidly been expanding enrollment and this trend is expected to continue. In fact,

enrollment rates are high also by regional standards although other countries such as Chile, Argentina, Uruguay, and Peru show rates already above 30 percent.

However, most of the expansion in recent years has taken place in private institutions, with 2 out of 3 students enrolled in a private institution, emphasizing the need for access to financing options especially for low income students.

There is significant inequality in access to tertiary education. As the education system expanded in the 1990s, the inequality in access to tertiary education grew in absolute terms. The largest absolute gains in coverage occurred in the fifth (and highest) quintile where net coverage rose from 23 percent to 40 percent. The expansion of tertiary education in Colombia has paved the way for better access to advanced training for less-privileged groups, particularly in the richer regions of the country. However, the increase in absolute enrollment of students from low-income families has been less than the absolute rise in coverage of groups already over-represented in the system. The net effect is that relative inequities worsened.

Lack of finance is a constraint for low-income students to access tertiary education and complete their studies. While enrollment among the poor is increasing, the financial demands are notorious and a financial bottleneck is looming. Indeed, 66 percent of per capita income is necessary to pay for tuition, fees, materials and living costs; well above the 30 percent average of the OECD. This reality only highlights the importance of providing financial assistance, especially to students from disadvantaged background.

Publicly supported student loan schemes can leverage private financing and increase enrollment in tertiary education. International evidence shows that there is a strong relationship between student financing and access to tertiary education: graduates from secondary school who receive financial support are 24 percent more likely to enroll in tertiary education. However, less than 10 percent of current tertiary education students in Colombia have a loan from ICETEX (*Instituto Colombiano de Crédito Educativo y Estudios en el Exterior*) to cover tuition costs. It is noticeable that, although this penetration rate is high by regional standards, it is low when compared to more developed countries. This could hamper the enrollment growth tendency that is being observed for Colombia.

Quality of education is uneven across institutions in Colombia. The growth of supply from the private sector generated noticeable enrollment growth but also important disparities in the quality of programs and institutions. The Ministry of Education has developed mechanisms to monitor and promote quality in higher education (i.e. the National Accreditation System), but these mechanisms have been implemented slowly¹. As such, information of the quality of programs and institutions readily available to the public is critical. In this regards, the modernization of the National System of Information on Higher Education is currently underway. This system will provide information on enrollment, drop-out and graduation rates per institution and programs, also providing key financial information. This will help both families and ICETEX in directing students and financing to desirable institutions.

To increase significantly the availability of student loans, both public and private resources are required. Public support is necessary to overcome a double market failure of: (i) information asymmetries between the lender and borrower. It is not easy for a lender to observe closely a student's ability or study efforts. The impact of this market failure is exacerbated by the lender's inability to collateralize education (unlike car and mortgage loans, the underlying asset in student loans, education, cannot be re-possessed) and (ii) externalities from knowledge and skill spillovers from the tertiary level graduates. Therefore, no large

¹ Although the accreditation system was created through Ley 30 of 1992, to date, only about 6% of existing programs are accredited.

scale student loan system has been built without continued public support. Nevertheless, substantial private financing is needed to scale-up student loans schemes. For example, in order to attain a credit penetration similar to that of more developed nations (about 35 percent) Colombia would need to increase its yearly investment in tertiary education financial assistance by around US\$ 475 million.

In Colombia, ICETEX is responsible for managing public funds for student financial assistance. ICETEX, the first student loan agency established in the world is thus, one of the most experienced public institutions managing student loans. The loan conditions are quite favorable: subsidized interest rate and up to 25 percent of tuition fees is forgiven for the poorest students. ICETEX increased the number of beneficiaries by creating a credit line named ACCES, through a World Bank-financed project² by 110,712 students in 2001-2007, while the overall enrollment rate in higher education increased by 30 percent in just three years. However, despite this increase, only a small fraction of public support for tertiary education is allocated for the purpose of loan schemes for the poor and the availability of financial assistance does not come close to meeting demand. The program needs to be scaled up.

ACCES loans have contributed also to the reduction of inequalities in the access and permanence to tertiary education. In 2002 only 20 percent of ICETEX beneficiaries were from the two lowest strata (out of six strata as defined in the Colombian SISBEN); since then, 69 percent of the 80,000 new beneficiaries brought in to ICETEX by ACCES belong to strata 1 and 2. In addition, the probability of dropping out for those who are part of the ACCES program is about 11.1 percent, compared to 35.7 percent for students that are not beneficiaries of the loan program. Therefore, the ACCES loans are helping ICETEX meet the challenge of improving access to and permanence in tertiary education for the poor.

ICETEX needs to improve its operational efficiency, loan collection practices, and must strengthen itself as a financial agency through new, innovative resource generating strategies. ICETEX has improved targeting techniques and is working to establish effective information technology platforms so as to increase the efficiency of its operation. Management has improved significantly, bringing down administrative costs from 13.2 to 7.6 percent. Still, there is a need to enhance the institute's capacity to manage its portfolio, recover outstanding loans, and reduce delinquency and default rates³. At the same time, it has recently converted into a public financial institution, which means greater control and supervision by the Financial Superintendency and therefore enhanced transparency and accountability. It also means that it is now able to tap additional resources from the private financial market, a great opportunity as well as a formidable challenge. ICETEX must upgrade its operation in order to properly respond to this challenge.

Rationale for World Bank Involvement. The World Bank has had a long engagement in tertiary education in Latin America and has assisted client countries in their efforts to address sector issues similar to those found in Colombia. For instance, the Bank has worked extensively on improving the quality and relevance of tertiary education in countries such as Argentina and Chile and has collaborated closely with countries such as Mexico, Venezuela and Jamaica in the set up of sustainable student loan mechanisms. It has also assisted Colombia with the current Higher Education – Improving Access Project (supporting the ACCES credit line, among other actions). Hence, the Bank is well positioned to keep assisting Colombia in tertiary education, capitalizing on lessons learned from the current experience with ICETEX, the region and around the world. The Bank, can provide not only additional financing to scale-up the ACCES program, but also – with support from the IFC- the technical assistance to transform ICETEX in a public financial institution. In this regard, the proposed loan is a natural continuation of the current ACCES

² The Higher Education- Improving Access Project (Loan IBRD 71550) approved in December 2002 which closes in December 2008.

³ Measurement of these indicators is difficult to compare across institutions because of different criteria used by each. ICETEX had a delinquency rate of 16.3% in 2005, defined as loans with more than two months in arrears.

project because it: (1) expands the coverage of ACCES, building on its success; (2) guarantees the continuity in disbursements of loans assigned during the implementation of the current ACCES project; (3) serves as a financial bridge for ICETEX while the repayment of ACCES loans begin; and (4) provides the resources and TA to ICETEX to allow for the development of a new and innovative resource-generation strategy (that includes very diversified options) that is now possible after its recent transformation into a public and independent financial institution.

The proposed project is fully aligned with the goals of the Country Partnership Strategy (CPS). In particular, it will support the CPS' twin overriding objectives of sustaining economic growth and ensuring a more rapid reduction of poverty. It would do so by providing advanced skills in high demand by the economy and increasing learning opportunities for students from low-income families.

2. Proposed objective(s)

The overall objective is to improve access to higher education in Colombia, in particular to enhance access to advanced learning opportunities for talented students from low-income families. Concretely, the project seeks to: (i) increase the availability of student financial assistance in Colombia for needy but talented students; and (ii) strengthen ICETEX's capacity to effectively manage its portfolio, reduce default rates and increase access to private capital and financial markets.

3. Preliminary description

The project is proposed to be an APL with two phases in a period of 6 years of implementation. The first phase (2008-2010) would be financed through a loan of US\$ 300 million with co-financing by ICETEX of US\$ 87 million. The second phase, (2011-2013) would be financed through a loan of US\$ 200 million with co-financing by ICETEX of US\$ 245 million. The project would be managed by ICETEX under similar implementation arrangements from those currently in place for the ongoing Bank-financed operation. The project would achieve the above-mentioned objectives during the two phases through two components:

Component 1. Equitable Access to Higher Education (total estimated IBRD financing: US\$ 490 million; ICETEX estimated co-financing: US\$ 332 million). This component would ensure access to tertiary education and lower repetition and drop-out rates for talented low-income students, as well as the improve the social, economic and academic conditions of low-income students through increased support of tertiary education institutions for program beneficiaries. In part, this will be achieved through the provision of student loans for low-income students who wish to access tertiary education and have the adequate qualifications to do so. The loan may be used to pay for tuition fees and/or living expenses while enrolled in school. The maximum amount of the loan would be 100 percent of the tuition cost for technical and technological programs, and 75 percent for university programs, according to the socioeconomic characteristics of the beneficiary as defined by ICETEX⁴.

Further to the development of the labor market observatory financed by the Bank under the ongoing operation, this project is expected to enhance information and career services. Similarly, ICETEX would continue working in coordination with the Ministry of Education on quality control and accreditation to ensure that the beneficiaries of loans enroll in reputable institutions and programs.

Interest rates for students will continue to be advantageous (that is, well below available market rates) although they will likely become variable based on market fluctuations. It is estimated that during the

⁴ The Colombian SISBEN is used to define these socioeconomic characteristics.

first phase of the APL (2008-2010) this component will assist ICETEX in providing 76,000 new loans (out of a total of 100,000 for the period) and will finance 333,000 renewals⁵ (out of a total of 433,000 for the period). During the second phase (2011-2013), this component will assist ICETEX in providing 49,000 new loans (out of a total of 110,700 for the period) and 220,000 renewals (out of 496,600 for the period).

Component 2. Institutional Strengthening of ICETEX. (total estimated IBRD financing: US\$ 10 million, no co-financing). This component would be designed to enhance portfolio and risk management, operational efficiency, collections, and access to financial markets in both phases. It is expected that the World Bank Treasury and the IFC will actively contribute in providing the TA critical for the success and impact of this component.

The **first subcomponent** would strengthen and modernize the management of ICETEX through the adoption of new technologies and information management systems for applicants' data. This will include software development for risk assessment, portfolio management, contingency and security, and information system development (confidentiality, data digitalization, etc.). The **second subcomponent** would contribute to the modernization of ICETEX and its insertion to the financial markets. In particular, this subcomponent will support efforts for ICETEX to tap the financial markets for capital through, for example, the issuing of bonds and securities. ICETEX also plans to explore initiatives to bring commercial banks and private investors into the financing of student financing assistance, through public-private risk-sharing arrangements, such as guarantee funds. The **third subcomponent** would support loan administration, in order to enhance its capacity to manage all phases of student financial assistance including the socioeconomic profiling of applicants, portfolio M&E, long term capitalization strategies, disbursement mechanisms, subsidy focalization and follow-up of higher education institutions and third-parties contributions. This will also include setting up a task force to reduce delinquency and default rates. Impact evaluation of this project will be conducted through this component.

This component will mostly finance consultancies

4. Safeguard policies that might apply

[Guideline: Refer to section 5 of the PCN. Which safeguard policies might apply to the project and in what ways? What actions might be needed during project preparation to assess safeguard issues and prepare to mitigate them?]

The project is not expected to have any environmental impacts and will not support any civil works. Student loans would be designed to target low-income, Afro-Colombian, and indigenous students. Specific criteria for including indigenous peoples as beneficiaries of credit for tertiary education will be developed during the preparation of the project.

⁵ Each new loan corresponds to a new beneficiary. The renewals correspond to loans for a new year of study to an already existing beneficiary. As such, a single beneficiary benefits with several renewals, depending on the length of her studies.

5. Tentative financing

| | Indicative Financing Plan | | | | Estimated Implementation Period (Bank FY) | | Borrower |
|-----------------------------------|---------------------------|----|------------------|-----------------|---|---------------|------------------------------------|
| | IBRD US\$ m | % | Others US\$ m | Total US\$ m | Commitment Date | Closing Date | |
| APL 1 Loan | 300 | 77 | 87 | 387 | April 2008 | December 2010 | ICETEX- Republic of Colombia |
| APL 2 Loan | 200 | 45 | 245 | 445 | January 2011 | December 2013 | ICETEX- Republic of Colombia |
| TOTAL for APL Loan | 500 | 60 | 332 | 832 | | | |

6. Contact point

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