A View from LATHR
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ICETEX - A STUDENT LOAN SUCCESS STORY IN COLOMBIA

by
Samuel Carlson

Human Resources Division
Technical Department
Latin America and the Caribbean Region
The World Bank

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PREFACE

In theory at least, student loans are a powerful mechanism for raising resources for higher education, and for using such resources in an efficient and equitable way. Yet, in practice, student loan schemes are perceived as being associated with high default rates that render their practical application questionable.

Colombia is a country with a long history of student loans. The ICETEX student loan program is an impressive example of higher education finance, mobilizing resources from students, parents, its own investments, universities, private associations, and government institutions at all levels. In almost 40 years of lending ICETEX has made more than 400,000 student loans for both public and private higher education and its loan arrears were just 12% in 1990. For in-country studies ICETEX finances all academic costs, while for study abroad academic costs, room and board and air transportation are covered up to US$4,000. At present 6% of all students enrolled in higher education receive ICETEX support; the challenge now is to expand this program to cover even more students.

George Psacharopoulos
Senior Advisor Human Resources
Technical Department
Latin America and the Caribbean Region
ICETEX - A Student Loan Success Story in Colombia

Introduction

1. ICETEX, the Colombian Institute of Educational Credit and Training Abroad, was founded forty years ago, originally to help students from lower income classes attend higher education institutions abroad. Soon thereafter its legal charter was changed so that ICETEX could make loans to finance higher education within Colombia, as well. Since that time ICETEX has been a successful pioneer in the field of higher education finance, demonstrating that financial responsibility, administrative efficiency, equity targeting, and expansion of access to higher education are all possible. In that sense ICETEX is a rare example of a success story in realm of higher education finance.¹

Background

2. The problems faced by Colombia in 1950 in the area of higher education were not unlike those faced by many Latin American countries today: financial resource constraints, a tradition of free higher education, inequitable access across socioeconomic groups, scholarship awards based on political patronage, overcentralization, rising social demand for higher education, and an economy which demanded well-trained higher level manpower. ICETEX was conceived in response to these issues and constraints. It took two years to design a legal, administrative and financial structure (and to overcome the pervasive mentality that a student loan program could never succeed), and the first student loans were made in 1952.

General Description

Legal Structure

3. ICETEX is a public institution with close ties to the Ministry of Education, but maintaining legal and administrative autonomy as well as its own financial capital base. It is overseen by a Board of Directors composed of the Ministers of Education, Labor and Foreign Affairs, the Secretary for Economic and Technical Affairs, representatives from public and private universities, and officials from both employer and labor associations. This assures representation from all important actors and focuses the program on responding to labor demands in the economy. An important feature of its legal structure is that ICETEX may oblige both public and private employers to deduct loan payments from debtors’ wages for remittance to ICETEX, added to fines paid by debtors who failed to comply.

Administrative Structure

4. Initially low funding levels required a lean administrative staff: the Director, an Assistant Director, a Treasurer, two secretaries and a messenger. The first step was to define methodologies for prudent accounting and finance practices, disseminating information, selecting applicants, administering and collecting loans, and ensuring adequate legal protection. As lending volume and services expanded, personnel were added. An organizational chart of the central office is shown in an Annex One.

¹ The author wishes to thank Gabriel Betancur-Mejia, who in 1990 conducted research and wrote a report regarding ICETEX for the Bank.
5. After identifying key skill shortages, ICETEX launched a national campaign through the mass media, publicizing its goals, programs, procedures and services. The appointment to the Board of Directors of a former President of the Republic and the head of the Treasury provided important credibility and attracted non-governmental trust funds to supplement state financing. The experiences of the first student beneficiaries were publicized in the press, radio and television, increasing public confidence in ICETEX.

6. An important feature of ICETEX is its decentralized structure. Currently, 21 Regional Offices administer all services for in-country studies, and most procedures for overseas candidates. Each office (1) manages its own loan portfolio, recovery and legal collection; (2) appoints its own technical, administrative and operational personnel; (3) is responsible for contracting, procurement and disbursement for goods and services corresponding to its own budget; and (4) develops regional student loan trust funds with the help of local universities and employer associations. This decentralization not only promotes accountability and financial responsibility, but also increases responsiveness to the local labor market, a critical factor in ensuring that higher education graduates find jobs and can repay their loans.

Financial Structure

7. One of the most impressive aspects of ICETEX is its diversified funding sources. For student loan resources ICETEX relies on portfolio recovery and interest income, regional development funds, trust funds from both private and public entities, income from investments, commercial bank credit and rediscounts, government contributions, international donors, and educational savings bonds. A chart showing the percentage contributions from each source is shown in Figure 1. It is this diversified financial base that has enabled ICETEX to continue offering subsidized loans to students while expanding its capital base.
Regional Development Funds

8. As can be seen, the largest source of money for student loans comes from the Regional Development Funds (RDFs). These funds are allocated by Colombian congressmen at their discretion through a budget item called "Parliamentary Aid". Departmental Assemblies and Municipal Councils create similar funds. In order to minimize political patronage these funds must be administered through ICETEX, which selects applicants based on intellectual merit and financial need. Note that National Government contributions constitute just 1.0% of ICETEX's financial resources.

Loan Portfolio and Interest Income

9. The second largest resource (20.8%) within the financial structure of ICETEX is portfolio recovery, that is, the loan repayments made by earlier beneficiaries of student loans. Repayment is always in cash and in monthly installments, according to two types of repayment plans: equal monthly payments or staggered payments with percentage increased on an annual basis. As of September 1990, ICETEX had US$20.4 million worth of loans in repayment status (73,814 loans) and only US$1.26 million of these loans were overdue, which translates into loan arrears of 12.4%. In constant present value terms, the Bank's recent study of student loan programs worldwide suggests that ICETEX recovers at least 53% of the value of loans disbursed, after deducting interest subsidies, administrative costs and default. In summary, while ICETEX is clearly not entirely self-financing, the high percentage of loan repayment demonstrates that student loan recovery is indeed possible, notwithstanding interest subsidies and other costs.

10. Interest income is also an important source of financing, and will become more so as the 1985 interest increase takes full effect. ICETEX loans were originally made at just 3% nominal interest, but in 1985 this rate was increased to 24%. In 1990 the market interest rate was 36%, resulting in an interest subsidy of 12%. Nevertheless, between 1985 and 1989 interest income increased at an average annual rate of 38%, totalling US$1.4 million in 1989.

Investments, Commissions and Savings Bonds

11. ICETEX also derives a significant portion of its resources from investments (18.7%), commissions charged to trust funds and sales of UNESCO bonds (3.5%), and education savings bonds (6.7%). Investment income has increased steadily as ICETEX has built its capital base and investment fund managers have improved their financial management, as can be seen below in Figure 2. Education Savings Bonds (TAEs - Título de Ahorro Educativo) constitute another financing innovation for student loans. In 1988 ICETEX was authorized to accept domestic savings and pay interest through securities called TAEs. These bonds guarantee that ICETEX will pay the beneficiary in installments equal to the value of the total or partial costs of future tuition fees, texts and other academic expenses, according to the type of bond purchased. Class A bonds will cover 5 years of

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2 It is worth noting that the U.S. Student Loan Program has a 17% default rate.

ICETEX INVESTMENT INCOME, 1954-89

Bank Credits and Rediscounts

12. After twenty years of positive experience with student loans and repayments the Bank of the Republic (BOR) classified ICETEX operations as a "development activity", which enabled it to open a rediscount window. Through the National Agrarian Bank and commercial banks the BOR established a special credit quota for the provision of funds to ICETEX at a discount. These banks charge an annual interest rate of 6%, which enabled ICETEX to lend up to US$7.6 million in 1990 at a financial cost of approximately US$460,000.

Trust Funds

13. Finally, another significant share of ICETEX's loan resources (8.5%) come from trust funds. These trust funds are administered by ICETEX on behalf of a wide range of public and private entities, ranging from trade associations, corporations, universities (public and private), government ministries, departments and municipalities, and foreign agencies. ICETEX and the interested entity work out a contract specifying the fund's objectives, amounts to be contributed and disbursed, servicing fees and mutual obligations. Each fund has an Administering Board composed of two representatives of the contracting entity and one from ICETEX. This board handles candidate selection, repayment terms, institutions for study, etc. In 1989 ICETEX managed 180 of these funds, providing important resources from both public and private sectors for higher education financing.
Loan Administration

14. ICETEX makes three types of loans: (i) long-term personal loans made to the student with repayment beginning upon completion of studies; (ii) short-term loans made to a student but with repayment over 6 or 12 months assumed by both student and parents one month after the first disbursement; (iii) medium-term loans similar to the short-term variety, but with just 50% amortization in 6 or 12 monthly installments, with the other 50% due upon finishing the last semester financed (balloon payment). Loans are extended for both formal and non-formal higher education, but in all cases the institutions to be attended must be accredited. Currently, ICETEX provides financing to 6% of the total higher education student population.

15. At the Central Office, the General Directorate of ICETEX carries out annual planning, training, control and evaluation, as well as national programming of the available funds among the 21 regions. Programming is done in cooperation with the Regional Offices, based on school calendars, target populations and local costs. The Central Office also defines priority areas of study, ensures that Regional Offices comply with all regulations, and selects beneficiaries for overseas study presented by the Regional Offices.

16. Each ICETEX Regional Office sets the credit amount to be given to a student, based on the type of higher education institution to be attended and the area of studies. Long-term loans are designed to cover total academic costs, while short- and medium-term loans cannot exceed the cost of tuition. Regional Offices are also responsible for publicity well in advance of the loan application cycle, using regional media channels.

17. Loan selection criteria are socio-economic and academic, based on disposable family income (as well as on family size, education and occupation) and student test scores. Each loan must be backed by personal guarantees from co-signers whose solvency must be approved by the Regional Office concerned. In addition, borrowers must contribute 1% of their loan to life insurance and loan guarantee funds. Loans are renewed so long as the beneficiary fulfills all contractual obligations and achieves satisfactory grades, as overseen by the Regional Office. The current loan renewal rate is 90%.

18. Targeting of priority areas of study is done in conjunction with the Colombian Institute for the Promotion of Higher Education (ICFES), which works with ICETEX to determine regional human resource needs. Loans for poorest groups are also made with long-term repayment plans, covering not only tuition costs but also living expenses equivalent to one monthly minimum wage. If the beneficiary returns to his hometown or is employed as a social worker part of the loan is canceled.

19. Repayment begins depending on the type of loan (see para. 14). For most long term loans the repayment period is determined by multiplying the number of semester disbursements by six. As mentioned earlier (para. 9), repayment is monthly and structured either equal or staggered payments.

20. Overdue loans are classified by time overdue into four categories, each engenders a different administrative action. Category 1 (1-3 months overdue) loans are referred to special collection officers within each Regional Office. Category 2 (4-12 months overdue) loans subject the beneficiary to "wage attachment", which means the employer deducts monthly payments plus a fine from the
beneficiary’s paycheck and remits that amount to ICETEX. Category 3 (13-24 months overdue) move into prelegal collection, and Category 4 (over 25 months overdue) loans authorize ICETEX to begin legal proceedings against the beneficiary. In 1990 37% of all overdue loans were Category 1, 39% were Category 2, and 23% were either Category 3 or 4. In any case, the reserve set up by ICETEX to cover loan defaults was three times greater in 1990 than the value of all overdue loans in Categories 3 and 4 combined.

**ICETEX Loans by Type, 1953-89**

**History of Operations**

21. In its 39 years of operations ICETEX has financed more than 400,000 student loans, broken down as shown in Figure 3. As can be seen, undergraduate loans for in-country higher education have constituted the vast majority (91%) of loans granted. 70% of these loans have been for attendance of private higher education institutions, although total enrollment at these schools represents just 60% of the total. Post-graduate loans for study within Colombia represented 6% of the total, while post-graduate study abroad made up the remaining 3%. Thus, a program initially set up to finance higher education abroad was adapted to serve students attending national institutions as those institutions developed.

22. The total value of loans granted each year for both domestic and foreign study is shown in Figure 4, showing the steady growth of ICETEX over the years. The total number of loans granted each year has roughly followed the same pattern. Out of a grand total of more US$200 million lent by ICETEX over the last 39 years, approximately US$150 million has been repaid. Of the US$50 million outstanding in 1990, US$30 million was in the period of disbursement and US$20 million was in repayment. Approximately US$2.5 million of those loans in repayment were overdue, 75% by less than one year.
ICETEX Targeting for Efficiency and Equity

23. A 1986 study of access to ICETEX financing evaluated the loan program according to application of its basic principles, namely: academic merit, financial need, geographic representation, and emphasis on skill shortages. In all respects this study indicated that ICETEX has indeed expanded access to higher education and respected its principles.⁴

Academic Merit

24. Using higher education entrance exams administered by the Colombian Institute for the Promotion of Higher Education (ICFES), we can compare average scores of all enrolled students with those of ICETEX applicants and beneficiaries. These scores are shown in Figure 5. Overall, ICETEX applicants scored 4% higher than enrolled students in general, while ICETEX beneficiaries scored 8% higher. Furthermore, ICETEX beneficiaries scored higher than students in general regardless of academic area. As yet another indicator of academic merit, a 1980 study compared retention rates of the educational system in general (by level) with those of ICETEX beneficiaries. At the higher education level the retention rate in 1980 among students overall was just 39%, while among ICETEX beneficiaries it was almost twice that (72%).⁵

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⁵ Jaime Barrera, ICETEX Technical Assistance Director, 1980.
Socioeconomic Status

25. Four indicators are used by ICETEX to determine socioeconomic status, the most important of which is net family income.⁶ As Figure 6 shows, 38% of all beneficiaries come from families earning an average of one minimum wage per month (i.e. between 0 and 12 minimum monthly wages per year), and 66% of them come from families earning less than two minimum wages per month (note that 70% of all undergraduate beneficiaries are dependents). By contrast, less than 2% of all enrolled students come from families earning an average of one minimum wage, and 66% of them come from families earning an average of more than three minimum wages per month. Interestingly, 62% of all applicants come from families earning less than an average of two minimum wages. This indicates that not only does ICETEX select students with the greatest financial need, but also that the public understands this targeting policy of ICETEX and submits applications accordingly. In more general terms, the analysis of beneficiaries by family income, education level, dependence and occupation suggests that 85% of all ICETEX loans are granted to students coming from the low and lower middle classes.

26. Another principle of ICETEX is geographic representation. Equal distribution across regions is difficult because of differing population densities and levels of economic development. That is, metropolitan Bogota is home to almost 20% of the Colombian population and has generally higher standards of living, which means a greater percentage of high school graduates and student loan applicants come from Bogota, compared to rural areas. However, the fact that those regions submitting fewer loan applications have a higher loan application acceptance rate than areas such as Bogota means that ICETEX is providing proportionally more aid to less privileged regions.

⁶ The others are family dependence, parents' education level and occupation.
27. Finally, ICETEX assigns priority to areas of study deemed important for Colombia’s economic development by its Board of Directors working in conjunction with the Colombian Institute for the Promotion of Higher Education (see para. 18). Traditionally, these areas have been health, engineering, public administration and education. As shown in Figure 7 below the emphasis given to these areas between 1983-1985 is clear. 74% of all beneficiaries were in priority areas, while beneficiaries in areas such as the Humanities and Social Sciences received less than 1% and 5%, respectively, of all loans.
Future Demand

28. The expansion of primary and secondary education in Colombia, combined with increases in tuition and living costs for higher education, mean demand for access to higher education and for student loans far exceeds supply. As mentioned earlier, ICETEX now covers just 6% of the total student population. For coverage to increase ICETEX must secure additional resources. This could be done internally by decreasing the interest subsidy, reducing repayment arrears even further with more aggressive collection, cutting administrative costs, and reducing the amount of credit extended to each student. All of these steps would generate some money but they are unlikely to be enough and might generate political controversy.

29. Externally, ICETEX could secure more resources through various ways: increased allocations from the national budget and parliamentary aid (the regional development funds); expansion of the rediscount credit window in the Treasury; increased sales of Education Savings Bonds; reduced government regulations on ICETEX investments which might generate higher investment returns; loans from foreign creditors; debt swaps for student loans; and/or receipt of a share of Colombia’s training funds. SENA, the National Apprenticeship Service, currently receives 2% of all public and private payrolls, including those for public and private education employees. At a minimum the payroll contribution of these employees could be channelled to ICETEX (this would represent about 10% of SENA’s income), increasing ICETEX resources by about 20%. Most of these measures would require approval by the President of the Republic, the Congress, and the Treasury. It is highly unlikely all of these steps can be taken at once, but at least some of them could be.

Lessons Learned

30. The ICETEX experience provides numerous lessons for Latin American policy makers and Bank staff interested in higher education finance. Some of these lessons are described below.

a. The loan institution’s objectives must be defined with clarity and objectivity.
b. The institution must have legal standing, its own capital or funding sources and administrative autonomy.
c. It needs continuity of management, both executive and mid-level, to ensure efficiency and quality.
d. Legal power to request wage attachment from employers of non-non-paying debtors is important, as is careful drafting of legal instrument for executive collection of loans, if necessary.
e. A system of guarantees, co-signers, life and health insurance for all loans is also essential, especially to attract third parties interested in entrusting the institution with loan funds.
f. Administrative structures need to be flexible, adapting as services expand.
g. The selection procedure of applicants is very important. This requires: (i) well-trained administrative staff with experience and commitment to the institution’s goals, which means proper incentives and attractive employment conditions; (ii) selection based on both academic and financial merits, so that the program is likely to support successful students as well as promote social change; (iii) areas of study to be supported should
fit both applicant aptitudes and labor market demands; (iv) institutions attended by beneficiaries should be of high quality, at least fully accredited.

h. Investments must be made in loan portfolio management (in training of staff; equipment such as computers, faxes, telephones; attractive salaries) and efficient structure for loan collection must be established.

i. Regulations concerning institutional investments should promote the greatest possible return while protecting capital, following the criteria of diversification and including overseas (dollar-denominated) investments to hedge against risk and inflation.

j. Maintaining contact with beneficiaries throughout the loan cycle (application, disbursement and repayment) is crucial, as is communication with "former beneficiaries", many of whom attain high positions and can support the institution financially and administratively.

k. Quality control should be ensured by outside auditors, through foreign technical assistance and polls among beneficiaries, seeking ways to improve.

l. Inflationary tendencies must be guarded against, by raising interest rates charged to students (or adopting a floating rate based on an inflation index), investing outside of the country, and seeking prompt repayment terms.

Conclusion

31. ICETEX has shown that a loan program designed for students with the greatest financial need and academic merit is indeed possible. Likewise, the capacity to ensure repayment by beneficiaries, to keep administrative costs down, and offer decentralized services nationwide has been demonstrated. The challenge now is to increase loan recovery in real terms, and to expand the coverage of the loan program. If 40 years of experience and the latest trends are any indication, ICETEX will continue to increase its efficiency, broaden its services and be an innovator in the field of higher education finance.
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