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CHOOSING THE TYPE OF INCOME-CONTINGENT LOAN: RISK-SHARING VERSUS RISK-POOLING*

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ABSTRACT: This paper analyses the choice between risk-sharing and risk-pooling income-contingent loans for higher education of risk-averse individuals who differ in their ability to benefit from education and inherited wealth. The paper identifies the possible outcomes of a majority vote between the two income-contingent schemes and provides several examples where the risk-pooling income-contingent loan is preferred. The paper then discusses the implications on participation and voting outcomes if successful graduates are mobile and provides examples where the riskpooling income-contingent loan remains being preferred. Risk-pooling schemes can however be prone to adverse selection problems, particularly if students are mobile. The paper explores the implications of allowing students to opt out of the riskpooling income-contingent loan for a pure loan. It shows that risk-pooling income-contingent loans can be sustained even when some students opt out.

JEL Codes: H52, I22, D72

Keywords: Voting, higher education, income-contingent loans, risk, mobility

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