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Challenges in funding, equity and efficiency in higher education

Summary

Equity and efficiency are complex issues in higher education financing. The issue is whether or not it is fair and efficient to have students pay for part of their higher education costs. This paper, based on a discussion by a panel of experts, explores whether tuition fees and student support can be geared in a constellation so that partici-

pation in higher education can be expanded without interfering with the accessibility of higher education for students from disadvantaged socio-economic groups. The discussion indicates that an optimal level of tuition fees cannot be found, nor an optimal level of grants, scholarships or loans. All is context related, in which history

and the labour market are important factors. But whatever the situation, it seems fair that students should have to pay part of the costs, but will also be insured against major financial punishments if they end up in lower-earning jobs after leaving higher education.

Key words: Cost-sharing, tuition fees, student support.

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1. Introduction

The concluding session of the conference “Funding, Equity and Efficiency in Higher Education”, held 21–24 November in Portorož, Slovenia, wrapped up many of the issues presented in the previous sessions and placed those issues into the wider perspective of higher education policy. The discussion panel consisted of:

Dr Milena Bevc
Dr Petr Matějů (co-chair)
Dr George Psacharopoulos
Dr Hans Vossensteyn (chair)
Dr Maureen Woodhall

The discussion was structured along a number of topics:

- Equity and efficiency in the debate on funding higher education.
- Do we want to increase participation in higher education and, if so, how?
- Do students need to pay a larger share of the costs?
- Do we want tuition fees?

- How should students be supported: grants, family support or loans?
- If loans, what type of loans?
- What about transparency of the financing system?
- If we want to make changes, where do we start?

The following text reflects the opinions of the panellists as well as the audience, and addresses the questions stated above separately.

2. Are equity and efficiency in higher education at odds?

There was a general conviction that efficiency (i.e. cost effectiveness) and equity are multi-faceted concepts in the debate on higher education. On the one hand, higher education systems in many countries produce more graduates and research with relatively less funding, making higher education more efficient. On the other hand, there are still many unexploited resources that could make higher education more efficient – for

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example, parental contributions from high-income families in systems with no or low tuition fees. In addition, one could consider students' own financial contributions, for example, through student loan systems.

In terms of equity, public opinion as well as the opinion of politicians inclines toward free higher education because this is felt to be "fair". However, the conference concluded that this often has a perverse regressive economic effect because it implies that the average taxpayers pay for the education of people that primarily come from higher socio-economic backgrounds and that will belong to higher socio-economic classes in the future. As such, free higher education stimulates social reproduction at the expense of the average taxpayer.

Regarding the question of whether equity and efficiency can be developed at the same time, the answer was to charge tuition fees and develop a fair system of financial support for students. In most countries, the majority of students come from higher socio-economic classes with distinct under-representation of students from lower socio-economic groups. Many studies have shown that the introduction or abolishment of tuition fees and changes in student support mechanisms have had no impact or a very small temporary impact on the socio-economic composition of the student population. These findings call for further research into more efficient and equitable mechanisms to finance higher education, with precise design and careful implementation.

3. Participation in higher education

There are mixed answers to the question of whether we want to further expand participation in higher education. Some countries already have a relatively high participation rate, whereas others would still like to expand their systems substantially. Many labour markets can handle higher numbers of graduates for high-skilled jobs. The issue is who decides on the expansion of the system and in what direction. The audience called for greater differentiation in terms of types of higher education institutions, programmes and qualifications. In addition, it was stated that merely expanding current public systems without charging tuition fees would attract greater numbers of students without increasing quality, or perhaps even lower the average quality of students and graduates.

The conference agreed that it is necessary to stimulate participation in higher education by talented but disadvantaged socio-economic groups.

The larger issue highlighted at the conference is that major educational inequalities become manifest much earlier than in higher education; these begin as early as preschool and primary education. In addition, strong tracking systems in secondary education may discourage transition into higher education.

4. Do students need to pay a larger share of the costs through tuition fees?

Previous analysis presented at the conference already indicated that the majority of participants favour tuition fees in higher education. Students should contribute to the costs of education through user charges (i.e. tuition fees) for both quality (of students and of programmes) and efficiency, as well as for equity reasons.

The debate then moved to the returns of higher education. Analyses at the conference showed that individuals benefit greatly from higher education, both in financial terms as well as in non-monetary terms, such as cultural development, appreciation of leisure and happiness. Of course these benefits differ between countries, institutions, disciplines and individuals. Regardless of such differences, tuition fees can easily be argued for due to the private rates of return. Nevertheless, it was also widely recognised that higher education also generates substantial externalities and positive social rates of return. These call for continued public investment in higher education.

Some participants claimed that higher education should be tuition-free because graduates pay tax at higher levels. Although higher-earning graduates indeed move into higher taxation brackets, this also holds for high-earning non-graduates that did not make use of the expensive higher education system. In addition, general income taxes do not differentiate between the public services that they pay for. Therefore higher education costs cannot be addressed through presumed higher taxation rates.

Addressing private contributions to the costs of higher education, the audience was undecided about the level of fees to be charged. Some arguments were made that the marginal costs of education should somehow be brought into balance with the marginal benefits. Of course, this is very difficult to calculate for individual students with different capacities and in different institutions and programmes. The issue of differential tuition fees also created some mixed opinions. On the one

hand, differential fees accommodate greater diversity in the system very well; on the other hand, it was also feared that differential fees might lead to a greater disparity between students from advantaged and disadvantaged backgrounds because the latter have more difficulty investing in higher-cost programmes.

With regard to whether tuition fees should be charged up-front or through a deferred payment system, the latter option was preferred because it is viewed as related to future income position rather than family background. It also removes any argument about liquidity constraints at the moment of enrolment. International practice has shown that deferred payment mechanisms such as those in Australia and the UK do not hamper access.

5. How should students be supported?

Practice shows that governments make use of an enormous range of arrangements to support students and their families. Systems that are in place are not easy to change. For example, indirect support through students' parents in the form of family allowances and tax benefits may not be changed easily because these often are more generic arrangements for larger target groups. In addition, these are often accompanied by parental maintenance obligations towards children that are formulated in national (i.e. constitutional) law. In addition, such support often can take hidden forms, such as free health insurance and transportation subsidies.

Grants to students are often more explicitly targeted to full-time students, to high-performing students, to poor students, or to a combination of these. Such direct subsidies may be vulnerable to political change and public demands for budget cuts. Regardless of their more targeted nature, grants often provide subsidies to students who do not really need them, particularly generic or merit-based grants. Generic grants often go together with the idea of making students financially independent (as much as possible), as in the Nordic countries. However, the participants agreed that addressing access issues particularly requires grants based on parental income as a way to stimulate students from disadvantaged backgrounds to participate in higher education.

However, student support in the form of student loans was generally preferred by the participants as a way to overcome liquidity constraints and to move the burden of higher education costs to the

time when future graduates are realising the economic benefits of their education, mainly through employment.

6. What type of loans?

How student loans should be given shape was still an issue of debate. Whether loans should be available to all students or only to needy students to a large extent depends on the amount of resources/capital that can be made available. It was undecided whether loans should cover living costs or tuition costs in particular; nevertheless, loans do have an investment character, and tuition paid for education is an investment in future employability. As such, they may be a natural link between tuition and employability.

With relation to the repayment mechanism, some prefer income-related repayment schedules in which one repays faster if one earns more, whereas others prefer traditional mortgage-style loans because national tax and debt collection mechanisms are not as efficient as needed.

An important issue regarding student loans is whether or not interest subsidies should be applied. The basic argument is that one should not offer student loans with interest subsidies. In doing so, the government subsidises students in a hidden way; the longer the repayment period, the greater the burden on public funds, and students do not perceive this as a subsidy or gift. Of course there is a case for keeping student loans as attractive as possible - for example, through using government borrowing rates that often are lower than private banking interest rates, which are often perceived as too high for students.

However, there may be very strong political reasons for interest subsidies on student loans - for example, to make loans acceptable politically and in the media. Furthermore, if one switches from grants to loans, the subsidy on loans is lower than on grants. Nevertheless, systems with low or no interest rates may lead to situations in which loans are in fact a gift of 50% to even 70%. This is an expensive way to lend money to students while those students continue to regard the instrument as a loan rather than a grant. This should be a serious consideration for student loan policies.

Finally, some loan systems include a risk premium. For example, in the Hungarian case the interest rate has a top-up risk premium of 1.7% to 2.0% to cover default costs. This represents solidarity among the pool of borrowers, whereby the well-earning graduates pay a little extra for the low-

earning graduates. This means that public subsidies can be fully used for direct grants to needy students.

7. Transparency and quality

This part of the discussion argued that any student financing mechanism should be clear and transparent. The government or student financing agency, as well as the media, should communicate very clearly the objectives of the student financial arrangements by providing proper statements on the following issues:

- What are the costs of higher education: study-related costs and maintenance costs?
- What are the benefits of higher education? (Rates of return, non-financial returns, differences for various disciplines, etc.)
- What are the tuition arrangements?
- How are students supported? What are the subsidies? (Direct subsidies such as grants and hidden subsidies through family support, tax relief, interest subsidies, debt remission, etc.)
- What are the eligibility criteria?
- Have as few instruments as possible and make uni-directional incentives: tuition fees can be addressed through loans, and maintenance costs can be subsidised through grants (and loans).
- Use similar mechanisms for different institutions, regions and target groups (even simple systems are often barely understood by prospective students and their parents).
- Monitor what is happening through student choice behaviour.

An interesting part of this discussion also addressed issues of efficiency, equity, tuition fees and student support in relation to teaching quality. What do students receive in return for their investments? To what extent does efficient operation lead to reduced quality? If resources are reduced or the number of students is increased, to what extent will this harm the quality of instruction? Finally it was argued that increases in private contributions through tuition fees and student loans should not be accompanied by decreases in public funding. Students should have the idea that they receive value for money alongside the fact that higher private costs should make them more responsible in the decisions they make.

Another interesting aspect touched upon was that we may ask students to contribute more to education costs, but that this is not the only way in which the current generation needs to contribute more to public and semi-public services, such as health care, social security and pension schemes.

Regardless of the fact that each of these changes in public systems can be persuasively argued for, together these arrangements can lead to a generation that is much poorer than previous generations, particularly in countries with strong demographic declines.

8. Where do we start?

The final part of the discussion was devoted to the question of "where we need to start" if we want to make higher education more efficient and equitable. There was a general sense of urgency that higher education institutions should first become more autonomous in how they spend their money without having to face budget cuts.

Because resources (money, political will, administrative capacity) are often insufficient to realise all the desired changes simultaneously and within a short timeframe, selected instruments should be implemented gradually. Introducing tuition fees and student loans, as well as clarifying information on hidden subsidies and perhaps also restructuring them into direct subsidies, requires a great deal of political will and strength. This is particularly difficult because many such measures are not favoured by students (who benefit from "free" higher education), and public opinion, political actors and the media remain convinced that private contributions will have a harmful effect on the participation of disadvantaged students. Nonetheless, most international research on these issues shows that these convictions are not supported by such arguments.

Nevertheless, the participants were convinced that more research is needed on the impact of financial incentives on student choice behaviour, particularly on people who do not participate in higher education.

The final remarks at this conference related to the potential impact on student financing policies from the European Union. The EU could provide incentives for national governments to develop more efficient and equitable higher education systems.

All in all, the conference made a valuable contribution to the general understanding of efficiency and equity in higher education. One important step was recognition of the impact of structures and opportunities in preschool, primary and secondary education on opportunities for students from disadvantaged backgrounds to enter higher education. The more egalitarian an education system is, the more likely it is that

students will be accepted into higher education on the basis of ability rather than social background. Student financing is a mechanism to further fine-tune participation policies and the incentives for investing in higher education.