

Common Misunderstandings about the Financing of Higher Education World Wide

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This paper is based on many years of labor in the scholarly and consulting vineyards of international higher education finance, governance, and policy formation, interspersed with years of practice as president of a college and chancellor of a large public university system. A culmination was more than a decade as Director of the International Comparative Higher Education Finance and Accessibility Project at the University at Buffalo, where my students and I dealt with the rich potpourri of financially, politically, and ideologically contested policy themes of college and university finance, student access, tuition fees, financial assistance, and student loans.

It has been this mixture of theoretical economics with the real world of college and university finance and management together with the international comparative study of higher educational finance and student access that I have found to be such a rich arena of both scholarship and teaching. In the course of this work, my beliefs have been abundantly challenged, just as I have frequently challenged the beliefs and policy prescriptions of others, many of whom are friends whose work I admire and from whom I have learned much. But also in the course of this work, which includes policy research for the World Bank, sponsored workshops in Dar es Salaam, Nairobi, Arusha, Prague, Moscow, and Wuhan, plus conferences and lectures in more than 40 cities and 36 countries, I have come across certain beliefs—many of which may be valid in some countries, and all of which have at least germs of truth as well as many serious and thoughtful proponents—that I believe in many ways to be incomplete or incorrect, at least as general propositions to guide policy, especially in low- and middle-income countries.

I have labelled fourteen such propositions as *common misunderstandings about the financing of higher education worldwide*. These beliefs, or propositions, are much more than straw men. I have heard and read all of them all, many by scholars, politicians, and practitioners ideologically opposed to *cost-sharing*—or the worldwide shift of higher education costs from being borne predominantly or exclusively by governments, or taxpayers, to being borne as well by parents and students—and unconvinced that tuition fees and student loans are higher educational policy imperatives for most countries. I may yet be persuaded of the correctness of some of these propositions. But for the most part, I believe these fourteen propositions too often lead to mistaken policies, and I will endeavour below to explain why.

Common Misunderstanding 1: The charging of public sector tuition fees, along with other manifestations of the growing privatization of public higher education, is an

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overemphasis on the private benefits of higher education and an under-appreciation (or even a denial) of its public, or social, benefits.

One of the least edifying debates in the discourse over the appropriateness of a tuition fee in the provision of public higher education is whether the benefits of higher education are *public (or social)* or *private*. Obviously, higher education brings both. Private benefits to students include greater productivity and greater lifetime earnings, as well as greater status, prestige, and socio-political influence, in addition to a wider choice of careers, mates, domiciles, and other life options. Parents of students also receive benefits, including the satisfaction that their children have all of the aforementioned advantages, as well as the added capacity to care for them if necessary in their elder years. Decades of studies have documented, and even attempted to place monetary values (sometimes expressed as a *return on investment*) on these undisputedly *private benefits*. Such research invariably concludes that the private benefits are generally high, but also that they vary according to the benefit being measured as well as by student characteristics, by program and degree level, and by country. But perhaps the most vivid demonstration of private benefits (or at least the perception of private benefits) is the simple fact that parents and students all over the world are paying large amounts of money—to public institutions with tuition fees as well as to private institutions and to private fee-paying tracks within public institutions—to access institutions of higher education.

Just as obviously, there are *public, or social, benefits, or positive externalities*, to higher education as well, including the economic growth and prosperity as well as the enhanced quality of life and social and civic virtues such as toleration and enhanced political participation that are generally assumed to *spill over* to populations far outnumbering the students who received the higher education—and well in excess of the private benefits presumably received by them. In this way, the benefits of higher education are not, for the most part, private *or* social. Rather the social benefits are extensions of much (although not all) of the private benefits from public and private higher education.

If the private benefits were assumed to be sufficient to induce the optimal amount of higher education (that is, a sufficient number of students or graduates, by program and level of attainment) and for these private benefits to be distributed equitably, then it might be assumed that the market would suffice without public subsidization: that is, with tuition fees sufficient to cover the costs and revenue needs of at least undergraduate instruction without further public subsidies (except for the minimal public subsidization and assumption of default risk required to provide student loans for all who needed them). However, it is generally assumed, in virtually all countries, that entirely tuition fee-supported instruction (whether provided by public or private providers, and assuming sufficient parental contributions or student loans):

- would not yield a sufficient number of college and university graduates to capture all of the externalities, or social benefits, of higher education;
- would especially not yield a sufficient number of graduates in particular fields, especially those that produce some of the most significant social benefits (e.g. nurses, teachers, scientists and scholars); and

- would not address the social goals of advancing equity among the very large number of potential students and parents unable to come up with the requisite tuition fees, even with loans and other forms of financial assistance, and therefore would not yield the equitable distribution of students and graduates to satisfy widely-held notions of social justice.

Thus, all countries accept the need for publicly subsidized colleges and universities. In fact, until near the end of the 20th century, virtually all of Europe, most of Latin America and Africa, and the Soviet Union, China, and the rest of the then-communist world provided most students with free or nearly free higher education. However, with soaring levels of enrollments and the surging costs and revenue needs of the late 20th and early 21st century higher education, public college and university tuition fees—usually nominal or moderate—now exist in nearly all countries, with the exception mainly of the Nordic countries and a few other European countries like Switzerland and some of the German Länder, as well as Russia and most other so-called *transitional* (or post-communist) countries that have preserved low or no tuition fees for some students, but that charge very high tuition fees for others. In the countries with public sector tuition fees, the fees range from the *nominal*, or less than 10 percent of instructional costs, to *moderate* from, say, 15 to 30 percent, to *high*, as in some of the high tuition states of the United States, where tuition fees at the undergraduate level may range from 30 to 40 or even 45 percent (Johnstone and Marcucci 2010b, pp. 102-128). Therefore, the majority of undergraduate instructional costs in almost all countries (as well as nearly all of the expenditures on sponsored research and public service) continue to be borne by governments and taxpayers. Thus, the existence or the level of tuition fees—whether no or very low fees, deferred fees, or relatively high fees—says little or nothing about the appreciation in any particular country of the social benefits of higher education.

Common Misunderstanding #2: High public sector tuition fees (e.g. in the range of 30 to 50 percent of instructional costs) reflects a prevailing political / ideological assumption that most of the benefits of higher education are private. Similarly, low or no tuition fees reflects the view that the benefits are predominantly social, or public.

This common, but at least partially mistaken, belief similarly links the presence or absence (or the level) of tuition fees to a country's prevailing political and ideological assumptions about the relative worth of the public sector, the proper level of direct and indirect taxes, and the role of markets versus governmental regulation and steering. There is clearly some truth to this association. The United States, England, Australia and some of the Canadian provinces have relatively high public college and university tuition fees, and they also tend to embrace more readily the privatization of public services generally, to exhibit more faith in markets, and to elect governments at national and state or provincial levels that endorse smaller governments and lower taxes.

At the same time, the acceptance of high public college and university tuition fees in the United States has been the case during periods of progressive, or left, governments as well. Furthermore, the acceptance of public sector tuition fees is very much influenced by: (a) the fact that public higher education in the United States is the province of the several states, which are generally forbidden to run deficits in their operating budgets and therefore must make up shortfalls in state budgets by turning to fees; (b) the extensive

and prominent private sector that has long featured much higher tuition fees and that has made the public aware of the existence of, as well as the need to plan for, tuition fees for their children; and (c) an established and well-funded system of grants and student loans from federal, state, institutional, and other private sources totalling in 2011 more than \$227 billion, nearly \$104 billion of which was in subsidized (means-tested) and unsubsidized student loans (College Board 2011, Table 1).

In contrast, the Nordic countries, which are the last bastion of totally free higher education, pass most of the very high costs of student maintenance on to students in the form of student loans. And England and Australia, while boasting of public universities that are free at the point of matriculation, actually defer their considerable tuition fees in the form of additional student loans. Finally, the highest public university tuition fees in the world are those in the so-called *dual track* tuition fee countries, including Russia and the rest of the countries emerging from the former Soviet Union as well as the other former communist / socialist countries of Central and East Europe and those in East Africa. Such countries still provide free or very low tuition fee university education (generally as required by their constitutions) to those applicants who score high enough on rigorous entrance exams to admit only the number of applicants in a given year that the governments can afford with such low (or no) tuition fees, allowing others who are deemed admissible to enter after paying very high—sometimes full cost—fees.

However, there is no pretence in Russia, Romania or Uganda that the public at large derives all of the benefit from the higher education of the governmentally-sponsored students—any more than there would be a notion that there is no public benefit derived from the so-called fee-paying track. The system is maintained by a framework law or a constitution that governments hesitate (or are politically unable) to amend and by cultural norms that approve of the reward of an expensive (to the state) higher education going to those who have achieved at the highest academic level by the age of university entry, even though those admitted as governmentally-sponsored are disproportionately from middle and upper-middle class families with university educated parents. But if anything, the bulging fee-paying tracks in the otherwise public universities of these countries support the notion of very great private benefits to higher education, with the free or nearly free higher education an artifact not so much of a belief in the predominantly public value of higher education as it is of a resilient political ideology that higher education is to be free—even if only to a few of the most fortunate.

In short, tuition fees are complex and need to be viewed in a total context of parent and student borne costs, both of instruction and of maintenance, and including both tuition and other mandatory fees, the many variations of tuition fees (e.g. up-front, deferred, or dual track), and financial assistance of all forms. With all of these factors considered, the level of tuition fees reveals little of the prevailing views about private as opposed to social benefits of higher education.

Common Misunderstanding 3: Free (or very low cost) public higher education for essential professions such as medicine (doctors, dentists, and nurses, and other health care workers), teachers, social workers, and such is an acknowledgement of the great public need for these professions, and thus of the very great social, or public, (as opposed to private) value of their higher education.

This is a program- or profession-specific variation on the first of the common misunderstandings, which was a justification of free or very low cost higher education for all based on an assertion of the primacy of social as opposed to private benefits. But the unchallengeable fact that we all need physicians (as well as nurses and teachers—and some would say even bankers and lawyers) does not make medical education (or any other kind of advanced professional education) a *public good* in the sense that economists use the term to identify goods and services that will not be produced in sufficient quantity or quality by the private market alone, and that thus that require a public (tax) subsidy to reduce their price and increase their production. A true public good has the essential characteristics of *non-rivalry*, meaning that its consumption by one individual does not reduce its availability for consumption by others, and *non-excludability*, meaning that once produced, anyone can consume or use it. It is in this sense that police protection, national defence, environmental preservation, the setting aside of certain land for public use, national defence, and true basic research are considered public goods that the private market would not adequately supply and that must therefore be subsidized (whether wholly or partially) by all citizens via taxation.

The same rationales for the subsidization of any kind of higher education apply as well to the education and training of physicians (or nurses or any other profession in great social need). We subsidize the high cost of medical education by a subsidized tuition fee or by subsidized financial assistance (or both) either because the very high cost of tuition fees with no subsidy would not produce *enough* physicians ... or because it might not produce the *quality* of physicians we need (i.e. as a result of the high tuition fees excluding too many of great potential ability from the education and therefore from the practice) ... or because we want to provide an *opportunity* for anyone to become a physician, and thus must lower the effective cost of medical education for a social equity purpose quite unrelated to the purpose of providing a sufficient number and quality of practitioners. Each of these rationales is socially and politically compelling, and explains why we subsidize medical education. But they are different than a rationale for very low or no tuition fees in medical schools for all medical students on the (mistaken) notion that medicine is a *public good*.

In other words, the *medicine is a public good and therefore medical education must be free* argument for no tuition fees in medical schools would hold only if there were no other less costly and less inequitable ways of a society getting enough qualified physicians. But there are. Young people go into medicine for the enormous private benefits—not just income, but for the prestige and the satisfaction of overcoming the academic challenges and entering a noble profession. They will pay (or borrow) for the opportunity, as will their parents, and the revenue from those who will pay—whether up-front (mainly from parents) or deferred in the form of loan repayments—is a very substantial source of revenue that can add to medical school capacity or quality or to financial assistance for those for whom the high tuition fees, even with borrowing opportunities, are still too high.

Government subsidies, then, can go into a partial subsidization: still leaving high tuition fees because of the very high costs of quality medical education, but bringing the fees down to levels that are possible to afford with parental contributions and student loans. If the tuition fees are too high to yield a sufficient number and quality of

physicians to practice in high demand but low remuneration specialties, such as general practice, or service in remote or otherwise difficult venues (such as in neighborhoods of high urban poverty), then the government can selectively subsidize those who practice in these subfields or in these venues by forgiving portions of indebtedness for every year that the physician (or the dentist or the nurse) actually practices that specialty or in that venue. In other words, if the public policy goal is to provide the best medical education for the common social good—that is, sufficient numbers of the most qualified physicians, including those who will practice in less remunerative specialties as well as in difficult or remote locations—there are almost certainly far more cost-effective ways than free or very low tuition medical education for all.

Common Misunderstanding 4: Promoting tertiary education among low-income and other financially marginalized elements of a society is better done with free (or at least very low cost) public higher education than with moderate tuition fees plus financial assistance.

Free or very low cost higher education—that is, the instructional costs of higher education being borne exclusively (or almost so) by the taxpayer—may indeed make better sense than moderate tuition fees plus financial assistance to maintain accessibility when all or most of the following conditions can be said to prevail:

- Higher or post-secondary education is *not* predominately the preserve of the children of more privileged families.
- The taxes to support higher education, particularly at the margin of tax increases, are relatively cost-effective and at least relatively progressive so that the additional taxes required to keep up with the rising costs are not themselves so costly to collect and do not fall disproportionately on the middle and lower socioeconomic classes (like taxes on consumption or utilities or the hidden taxes of deficit induced inflation).
- Prevailing cultural norms would have tuition fees—if they were to be charged—being paid mainly by the students rather than the parents anyway.
- There are few academically respectable tuition-dependant private universities to suggest how much the free or low tuition public universities are *walking away from* in the provision of free or very low fee higher education for all.
- The *opportunity costs* of the inevitably increasing government budget for higher education—that is, *the next best foregone alternative expenditure* that might have been made if some of the additional revenue needed for higher education could come from other-than-tax revenues instead—brings less public good than the benefit attained by the continued spending of ever higher tax revenues on higher education. (In other words, there are few great public needs that are not being achieved because of a lack of public funding that could be funded with a shift of instructional costs from government to parents and students.)

The above conditions are generally met in the affluent Nordic countries, where there would seem to be no significant policy advantage to the imposition of even moderate tuition fees, which would certainly be fiercely resisted anyway by parents and student alike (even though parents clearly could and probably would pay a modest tuition

fee if it were required). At the same time, in most countries of the world—and especially in middle- and low-income countries:

- Higher education *is* disproportionately the preserve of the middle, upper-middle, and upper classes.
- The raising of government revenue *is not* particularly progressive (especially when achieved through inflationary confiscation of purchasing power by deficit spending), nor is most taxation cost-effective at the margin. (That is, taxes tend to be not only regressive, but difficult and expensive to collect.)
- Parents *do* believe that tuition fees, if charged, are properly theirs to pay if they are at all financially able—making the charging of tuition fees and means-tested financial assistance another means of achieving a bit of socially desirable income redistribution.
- Private, tuition fee-dependant higher education is common, growing, and generally respectable (frequently in the United States of greater prestige than the much lower tuition public institutions).
- The queue of socially and politically compelling, yet unfunded, public needs (e.g. elementary and secondary education, public health, public infrastructure) is long and formidable, suggesting that additional public revenue every year to higher education has a very high opportunity cost.

Many of these conditions are met in countries as widely disparate, for example, in per-capita wealth, the quality (however measured) of colleges and universities, higher educational participation rates, and most social and cultural norms as the United States, China, Russia, Brazil, Kenya, Burkina Faso, and most of the countries of Continental Europe. The United States and China (as do Japan and Canada) have significant tuition fees in their public institutions of higher education already—in the range of 20 to 40 percent of instructional costs. Most of the countries in Continental Europe, the transitional countries of the former Soviet Union, most of Africa, and most of Latin America, however, feature no or very low tuition fees in their public institutions of higher education (or at least in the governmentally-supported tracks in the so-called *dual track* countries). In such cases—and especially where the raising of additional taxes is difficult and largely regressive, where college and university students come disproportionately from the more affluent and privileged classes, where there are growing private sectors to demonstrate the ability and willingness of many families to pay a moderate tuition fee, and where financial assistance exists—a failure of the government to impose at least a moderate tuition fee can be said to *leave behind* revenue that could otherwise have improved higher educational quality, capacity, or funds for financial assistance.

Common Misunderstanding 5: Public sector tuition fees constitute the principal financial barrier to higher educational accessibility and wider participation.

Although tuition fees are the political *third rail* of higher education finance, as long as tuition fees are in the moderate range (say, 15 to 25 percent of instructional costs), and as long as most students throughout the world are unable to attend full time and still live at home, the costs of student living, or maintenance, are by far the greater financial barrier that most students and their families must somehow surmount. Furthermore, on top of food and lodging are the costs of books, examination and registration fees (unrelated to

tuition fees), computers, and other educationally-related expenses of higher education, plus all of the other costs of living like clothing, entertainment, transportation, mobile telephones, and the like. This is not to deny the fact that finances may be a critical barrier to higher educational participation for young persons from low income families. But there are generally other, and far more cost-effective, ways of reducing these barriers besides very low or no tuition fees for all students: specifically, means-tested, or targeted financial assistance along with moderate tuition fees from those parents and students who can and will pay a portion of the underlying costs of instruction.

Common Misunderstanding 6: The politically and ideologically contested imposition of (or increases in) tuition fees in public colleges and universities is nothing more than a choice by the governments to not raise taxes as an alternative to the “effective tax” of the tuition fee.

A key rationale supporting some measure of cost-sharing in many countries is worth restating: that the burden of additional taxes and deficits in most countries, however much governments may wish or claim them to be otherwise, are at least *proportional* and likely to be *regressive*—that is, falling on all citizens, including the poor, rather than falling *progressively* mainly on the wealthy—and those benefitting from the low or no tuition fees tend to be at least disproportionately from the middle, upper-middle, and upper classes. However, two additional points, also suggested above, need to be made. First, the opportunity costs of additional public revenues going to higher education, particularly in middle- and low-income countries with their enormous backlogs of unfunded needs in sectors such as elementary and secondary education, housing, public infrastructure, or sanitation and environmental restoration, suggest that higher education in most countries (including the wealthy ones) is almost certainly not at the front of the queue for any such additional public revenues. Second, it is not at all clear how much additional tax or borrowing revenue is even possible, especially in the middle- and low-income countries that are already near the limit of taxes that can be added cost-effectively, and that are also at or near the limit of their ability to borrow. In short, additional taxes in many countries are unlikely—but even if they could be realized, higher education is not likely to be the beneficiary.

Common Misunderstanding 7: The need of all countries to be competitive in the increasingly globalized world economy—and for young men and women to have jobs paying decent salaries—requires that more young people receive at least a bachelor’s degree.

The evidence is quite conclusive that earnings increase with level of education, and will undoubtedly continue to do so. But the evidence is mixed and complex when it comes to the *need for all* or even *for more* young people to have bachelor’s or even associate degrees. Unemployed and underemployed college and university graduates are phenomena in almost all countries. Restaurants and bars in the United States may *prefer* to hire college graduates (25 percent of bartenders are college graduates), but the US bureau of Labor Statistics does not classify bartending as an occupation *requiring* a college degree (Harrington and Sum, 2010). Harrington’s and Sum’s analysis of US labor Market data showed that nearly 16 percent of recent college graduates were working in retail sales, 10 percent as bartenders and wait staff, and 6 percent as secretaries or office

assistants—none of which occupations are classified as requiring education beyond the high school. The notion that we need all, or even more, bachelor's level graduates may arise because we confuse the *facts* that: (a) most *good* jobs require college and university degrees; and (b) some of the fastest-growing and shortage-prone occupations throughout the world not only require advanced degrees but need *more* such graduates; with our legitimate *belief* that (c) all young people should have an *opportunity* to attain such high knowledge-content, highly remunerative, jobs—and therefore that many aspirants, will need to acquire the high levels of education necessary to having this opportunity, even if many will have to drop back to an occupation that does not require the higher degree when they fail to attain the positions or even the occupations to which they have aspired.

Of course, both the public and the private benefits of higher education extend considerably beyond acquiring a particular job, and there is nothing inherently wrong with a level of under- or unemployed college or university graduates—if it can be afforded and if the extent of unemployment among college and university graduates does not have other economically or socially undesirable consequences. But to maintain that all or even most jobs literally require a bachelor's degree, even in the highly industrialized countries, now or even in the immediate future, is manifestly not the case.

Common Misunderstanding 8: The tuition price elasticity of higher education—that is, the effect on (or drop in) enrollment as a result of an increase in tuition fees—is considerable and is therefore essential to the making of good public policy in the financing of higher education (that is, balancing the need for greater revenue with the need for maintaining widespread participation and accessibility).

The effect of changes in tuition fees, financial assistance, or the composition of financial assistance (e.g. between grants or loans, or between high or low interest rates) on *enrolment behavior* is critical to making appropriate policy on tuition and other fees and on the eligibility for, and the generosity and composition of, financial assistance. Tuition price elasticity has been the subject of considerable research in the United States, the United Kingdom, and other OECD countries. More refined research has studied the effect of changes in net tuition fees—that is, after financial assistance. However, it is virtually impossible to perform a true *medical model* experiment: that is, where randomly selected sets of applicants receive different packages of tuition fees and financial assistance, with no possibility of post-experiment revisions or alternative tuition fee and financial aid offers. Therefore, the research must either be *quasi experimental*, in which changes in enrollments are studied through regression analysis to search for a possible explanation in changes in tuition fees, or *survey research*, in which an applicant or current student is asked what he or she might do under a number of hypothetical changes in tuition fees.

Such research generally shows little effect from changes in tuition fees for most students, but generally does show effects on those from lower socio-economic backgrounds, who may have little or no way to absorb even a modest increase in fees, or those who may be more ambivalent from the start about the academic rigors of college or university (Johnstone and Marcucci, pp. 202-222). At the same time, at least in the United States and other countries and regions where there are post-secondary alternatives from which the student (and generally also the family) can choose, the effect of an

increase in tuition fees and/or a reduction or change in financial assistance, may not mean a decision to not attend or to drop out, but rather to take a part-time job or to work longer hours, or to borrow more, or (particularly in the United States) to change to a lower price institution or to move back home with one's parents.

Thus, the scholarly and policy interests in tuition price demand elasticity is not exactly a misunderstanding, nor is it incorrect or unimportant. To the contrary, the effect on enrolment behaviour of policy changes in tuition fees and financial assistance is of profound importance. But most of the research findings that are most frequently cited—e.g. that each \$100 of tuition increase will cause a certain percentage drop in aggregate enrollments—is so contrary to all observations, and so misses the range of important behaviors other than the decision to enroll or not enroll, that it provides little guidance to public policies on appropriate tuition fees and financial assistance, and may even provide incorrect, or in any event incomplete, projections of likely student behavior.

Common Misunderstanding 9: If a country can no longer afford free or very low fee public higher education (as more and more countries seems to be deciding), then countries should maintain higher education free at the time of first degree matriculation and defer the payment of tuition fees until after graduation (preferably, like England and Australia, arranging for payment via a requirement of employers to withhold a percentage of earnings from each pay check, similar to pension or health insurance contributions or to the withholding of income taxes, until the loan is repaid).

The Australian and English plans of deferred tuition fees to be repaid as income contingent loans have two distinct features: both with strong proponents, and especially when taken together—but each with certain downsides as well. First, and the cardinal feature of the English plan, is the proposition that higher education should be free at the time of matriculation, although there can be a tuition fee as long as it is deferred until after completion (Barr and Crawford 2004). A tuition fee that is free at the time of matriculation, and then to be repaid by the student after completion as a loan, is attractive to many students because it releases parents from the obligation of paying tuition fees and treats all students as financially independent (even if generally impecunious) adults. The downside of that supposed advantage is that it shifts a financial burden that in most non-Nordic countries (and in the UK from 1997 to 2006) is (or was) considered an appropriate obligation of *parents*—at least for those able to pay—instead to *students* (in addition to the living costs that students may also be bearing). A special downside to low income students is that any means tested grant or tuition fee reduction that is (or was) based on the family's low income no longer applies. Thus, when England changed in 2006 from an up-front but means-tested tuition fee paid by middle, upper-middle, and upper class families to a deferred fee paid by all students, the *winners*, of course, were the parents who were no longer expected to pay, and the *losers* were the students, especially the students of low-income families, who (or whose parents) had not previously had to pay any tuition fee.

Common Misunderstanding 10: If a country is persuaded that public sector tuition fees are financially necessary (whether up-front or deferred) and that student loans must be offered (whether to cover tuition fees, the costs of student living or both), the loans

should be repayable as a percentage of future earning rather than repayable on a fixed schedule of payments, like a mortgage or a conventional consumer loan.

Policy analysts, politicians, students, and many economists have been fascinated for the past fifty years over the idea that student loans might be repaid not on a schedule of fixed repayments, but as an obligation to repay a certain percentage of earnings until the debt was repaid with interest, or until (for low earners) a certain number of years had passed while repaying this percent of earnings, but without being able to discharge the debt, at which time any remaining debt would be cancelled. Economists tend to be especially intrigued by the pure form, where surplus interest paid by high earners effectively covers the shortfalls on low earners, turning a student loan into a form of equity, where students are viewed as selling shares of their future earnings in return for the capital needed to invest in their educations. The high risk of generally available student lending, the problem of *adverse selection* (whereby students who plan a low earning career such as the ministry or public service will rush to participate, while those who believe they will earn high incomes tend to decline), and the difficulty of capitalizing or securitizing income contingent loan notes have limited the adoption of income contingent student loans except for governmental loans. The most noted of these are the Australian and English models, which combine the presumed advantages of deferred tuition fees (i.e., higher education free at the time of matriculation) with the presumed advantages to students of the income contingent repayment obligation. (The presumed advantage extends as well to politicians, who generally wish to please the students, especially when venturing into the politically treacherous waters of tuition fees.)

However, although loans with income contingent repayment obligations may be thought to be greatly superior to conventional loans with fixed schedules of repayments, it is first important to note that most students will repay exactly the same amount—measured in true simple interest, or the discounted present value of the payments—on the income contingent schedule as they would have on an equivalent conventional, or mortgage-type, loan on a fixed repayment schedule. This is because a loan is *cheaper* only to the degree that it will be repaid at a lower rate of interest, and there is nothing in an income contingent repayment schedule that makes it any more subsidized, or cheaper, at least for most borrowers, than a conventional loan—although the payments indeed may be more *manageable*, as long as a constant percentage of income is assumed to be more manageable than a fixed, known, schedule of repayments.

Also, as virtually all income contingent loan schemes have some maximum repayment period after which the remaining debts of borrowers who have had low lifetime earnings, and have been unable to fully repay their obligations, will be forgiven, the *generosity* of an income contingent loan scheme depends on the percentage of earnings that are to be repaid (usually monthly) and the number of years a borrower can be held to continue repayments. A high percent of earnings to stipulate the monthly payments together with a long maximum repayment period would constitute an *ungenerous* loan, meaning that a borrower would have to be quite destitute over his or her earning lifetime to trigger the forgiveness of a remaining debt. Conversely, a repayment contract featuring a low percent of earnings for the monthly payments and a short repayment period would probably mean that many borrowers could reach the end of the maximum repayment period with a remaining debt to be forgiven. The point is that any

repayment obligation—fixed schedule or income contingent—can be made cheaper with a lower rate of interest (i.e. a larger subsidy), and any conventional repayment schedule can be made more manageable by extending the repayment period and by providing easy refinancing, deferment or forbearance in the event of unemployment or low earnings. In short some proponents of the income contingent form of repayment obligations portray the income contingent form as better for all students. But more accurately, the form is clearly better only for some students—and the degree of *better* and the proportions of borrowers for whom the form will in fact be better depends on the elements of governmental subsidization that are built into a particular income contingent scheme—not, in the end, unlike subsidies that can be built into other forms of repayment obligations.

Nor is an income contingent repayment necessarily better for the lender. Income contingency in the Australian and English models is sometimes mistakenly equated with the collection of payments by the employer at the point of wage or salary payments, as in income tax withholding or pension contributions. However, a government that can obligate employers to collect the income contingent loans of their employees can presumably do the same for student loans of a conventional variety. And there may even be a downside to employer-collected student loans. For example, the income contingent repayment option that has existed for many years in the United States is not collected by employers (nor is it particularly generous) because the US Internal Revenue Service does not want to jeopardize its high level of voluntary income tax compliance by attaching a task unrelated to the collection of taxes onto the laws and regulations of income tax withholding. This is not to disparage a loan scheme that relies on employers to collect (although such collection is difficult to impose on the self-employed and those working out of country). The point is only to disassociate *employer collection* from *income contingency*.

A downside of income contingent loans to the lender (meaning the governments in England, Australia, and all other countries that currently provide generally-available income contingent student loans) is that the lender (i.e. the government) comes into possession of assets in the form of contracts or notes by which the student borrower pledges to repay a certain portion of earnings until the debt is repaid at a certain rate of interest or until so many years have passed. However, unlike conventional fixed-schedule loan notes, which have a market value and which can be sold in a secondary market or securitized to raise capital from the private capital markets, these income contingent obligations have, at least through early 2012, almost no market value. Governments can keep them on their balance sheets as assets of very indeterminate value. But if the point of the deferred tuition fee in the first place was to provide a non-governmental, supplemental source of revenue to the country's public colleges and universities, it helps little if the tuition fees must be expensed on the government's operating budget and required to compete with all other public expenditures. England and Australia can borrow this money and add it to their debt—comforted, perhaps, by the knowledge that there are some counterbalancing assets on their balance sheets, even if of uncertain value and worth little on the world capital market. But for a low income country that is heavily constrained by its existing debt as well as by the competing claims on the government's operating budget, the assets of deferred tuition fee obligations may be of very little help.

In the end, student loans of the income contingent variety are clearly more acceptable to students and politicians as well as to many economists and policy analysts. And there are clear advantages, although some of the advantages, such as employer collection at the time of wage and salary payment are not strictly a feature of income contingency, and there are other ways short of income contingency to protect the low earner from unmanageable debt. Thus, my rebuttal to the too frequently passionate advocates of income contingent loans is not that the advocates are altogether wrong, or that this type of loan is necessarily bad, but that the concept of the income contingent student loan is too frequently misunderstood as well as oversold.

Common Misunderstanding 11: If a country can no longer afford free or very low fee public higher education for all (for example, as Russia and the other countries of the former Soviet Union, as well as the countries of formerly communist East and Central Europe and many of the countries of Sub Saharan Africa have decided), it is still preferable to provide free or very low fee public higher education for as many as is financially possible, beginning with the most academically meritorious.

Discussion of a number of the misunderstandings has raised the so-called *dual track* tuition fee policies that are found in many transitional and other countries where free or very low fee higher education is a political imperative, but where the public revenues are insufficient to the policy. The dual track compromise provides free or very low cost tuition fees to the most academically able, while admitting a substantial additional number (up to 80 percent in Uganda's Makerere University) of supposedly qualified students, but only at a very high tuition fee. The countries adjust the cut-off point on the entrance examination up or down (generally up) to yield just the number of new governmentally-sponsored students that the government can support at the low or no tuition fee, and then admit a sufficient number of others at the much higher, privately-sponsored tuition fee in order to expand the university's capacity at little or no additional cost (and perhaps sometimes a profit).

The problems with dual track tuition fee policies are two. In the first place, they are generally considered to exacerbate the inequities that are already present in virtually every system of higher education: the disproportionate representation of students from already privileged families. It is true that by providing low or no fee higher education to the most academically able, such policies are able to accommodate the poorest students—provided only that they have excelled academically in their secondary schools. At the same time, academic achievement and ambition in every country are, at least to a degree, socially and culturally constructed. Sons and daughters of the privileged have the likely advantages of better secondary schools, more academically ambitious peers, and the cultural capital that comes from homes with educated parents, books, and the like. A dual track, or parallel, tuition fee policy takes care of the most academically able of the poor. Meanwhile, the children of the privileged, both the academically able and the less able, are always taken care of (if not in the most prestigious universities, then in colleges or universities that are always accessible and that still bring a private return). It is the student from the low income family who is academically able and ambitious—but not quite enough to get into the governmentally-sponsored tracks—who is denied the opportunity of higher education because the family cannot afford the very high tuitions

either of a private college or university or the private, fee-paying, tracks in the public institutions.

The other problem with the dual track policy is that the tuition fees are too low—that is, lower than they need to be, and therefore foregoing additional revenue in the governmentally sponsored track, and too high—that is, high enough to deny opportunities to students from low income families in the fee-paying track. Dual track tuition fee policies are deeply rooted in political and ideological cultures and are resistant to change. However, as the university-qualified applicants get more and more numerous, and as financial austerity continues to limit the numbers admitted in the governmentally-sponsored tracks, and as the proportions of students in the fee-paying tracks also continues to rise, there may come a time when the numbers in the governmentally sponsored ranks are small enough to resemble a set of generous merit-based scholarships. At that point the much-criticized inequality of the dual track policies are similar to, and certainly no worse than, the also much criticized (at least by most academics and policy specialists) increase in merit-based scholarships in US public universities—also a product of politics and of a culture that wants to reward merit more than assist those considered less academically deserving, but for whom the aid or the low tuition might actually make a difference.

Common Misunderstanding 12: If countries can no longer afford free or very low fee public higher education for all and must raise tuition and other fees—of course combining this with programs of financial assistance to maintain accessibility—it is better to maintain access with grants than with loans because: (a) too many students, especially from low-income families, are culturally debt averse and will simply not borrow, thus effectively continuing to deny them access to higher education; and (b) very many student loan programs throughout the world have failed financially due to high defaults and to the very high cost of servicing the debts.

There are important policy caveats—germs of truth—to this position. One is that there are indeed some cultures in some countries that seem to be averse to debt: perhaps especially averse to higher educational debt for a young woman. At the same time, like the study of tuition price elasticity, research into student or potential student debt aversion is difficult and frequently inconclusive. Students or potential students can be surveyed as to their likely behavior or feelings under hypothetical situations presenting a need for additional money, asking them how they feel about higher educational debt, or the circumstances under which they might take a loan as opposed to some other behaviour, such as abandoning plans to enroll in a college or university, or dropping out, or attempting to get by on even less in their living expenses to the point of damaging their health. However, student may well believe that any response other than the most dramatic and unacceptable to policy makers—such as threatening to drop out or abandoning plans altogether for a university education—may be an invitation to the policy makers to go ahead with the government's plans to impose a tuition fee increase or to change the offer of a grant or bursary to the offer of a loan.

Of course, debt aversion can indeed be serious enough to deny some students, particularly young women, of some cultural backgrounds in some countries the option of a loan, which may mean a virtual denial to them of the opportunity for a higher

education. At the same time (and to be deliberately provocative), higher education itself in some countries in some cultures was once considered inappropriate for daughters, but this has fortunately changed dramatically. In fact, although some cultures are still averse to certain aspects of modernity such as casual dating, most have accepted, for example, credit cards, cell phones, and even advanced professional education in business or law. Nowadays, the willingness to assume indebtedness for the opportunities that are opened through higher education may be another aspect of modernity that may still be difficult for some families to accept. The issue, then, may be the extent to which the general taxpayer should be asked to accommodate a persisting cultural aversion to educational debt by the greater governmentally-borne costs of grants or low tuition fees for all in lieu of loans.

The other germ of truth to the declaration that student loan schemes “just don’t work” is that many have indeed failed financially; in fact, the developing world is littered with failed loan programs. Shen and Ziderman (2007) have shown many instances of student loan programs in which the discounted present value of the reasonably anticipated repayment stream is far, far less than promised when the loan program was inaugurated as a step in the direction of cost-sharing—and a few of the worst examples in which the present repayment value is so low that the government would actually have saved money by giving the money to students as grants rather than loans in the first place and saved the expense of attempting to collect.

However, these examples (and there are more than a few) quickly reveal a number of reasons why student loan schemes fail, as well as how failures can be lessened or prevented (Johnstone and Marcucci 2010a, 2010b). In most cases, for example, interest rates were set far below the cost of money, meaning the program would have failed financially even if all borrowers had repaid. Furthermore, student loan schemes have commonly been put into place with no instructions or counselling about what it would mean upon completion of studies to have an accumulation of debt or what would be the consequence of default. In fact, many governments, fearing student reaction against any semblance of cost sharing, did not even acknowledge that a new scheme such as a deferred fee actually amounted to a tuition fee and a loan. Such plans generally did not have any money passing through the students hands, but simply noted a debt by virtue of having been enrolled—a debt that students, upon completion, may well have forgotten, or in any event been totally unprepared for (even if they remained in the country). Frequently, governments put loan schemes in place with no technical or legal preparation for servicing the loans, making collection unlikely even if the borrowers had initially had the inclination to repay. In other words, our studies of student loan failures make it so clear why so many loan schemes have failed that we believe student loans *can* work: with the sufficient initial capitalization, the willingness of government to absorb a share of the inherent risk, an appropriate interest rate, the involvement of the college or university, and a proper professional approach to debt servicing and collection (Johnstone and Marcucci 2010a, 2010b).

Common Misunderstanding 13: If countries can no longer afford free or very low fee public higher education for all and must inaugurate a policy of tuition and other fees (combined with programs of financial assistance to maintain accessibility), these tuition fees should at least be increased as little and as seldom as possible.

The point of shifting some of the costs of higher educational instruction from governments to parents and students is that the trajectory of instructional costs, driven both by increasing per-students costs and by surging enrollments, is exceeding in almost all countries the trajectory of available governmental (i.e. tax) revenues. The result of these diverging trajectories, again in nearly all countries, is annually increasing institutional austerity, leading to constrained capacity and diminished quality. It is clearly the case that tuition fees are politically contested and that they can impose real hardships on many families and students—to the point of limiting or at least altering higher educational accessibility. However, if the reason for tuition fees is the inability of government to keep up with higher education’s surging costs and revenue needs, and if these costs and revenue needs increase virtually every year (especially with increasing enrolment demand), and if provisions are made for maintaining accessibility through means-tested grants and loans, then any freezing of tuition fees means that the government’s share must increase even more—to make up for the parent’s and student’s share not increasing at all—or the colleges and universities must make even further cuts. Furthermore, when the government, having inaugurated a policy of modest tuition fees then freezes these fees—probably in the face of nearly all other expenses and prices continuing to rise—the government is sending a confusing signal to students: that their higher education, which has a highly subsidized price to begin with, and the underlying costs of which keep rising every year, should nonetheless somehow be immune from the inflation that the student sees everywhere else.

The preferable policy is for a government to determine an appropriate (at least approximate) share of instructional costs to be borne by parents and students—which share will necessarily be affected by e.g. history, the prevailing economic and political ability to keep raising taxes, the extent of a fee-dependent private sector, and the strength of the financial assistance system—and then to maintain that share, *meaning likely small fee increases in most years*. But a policy of maintaining an appropriate family share also serves to focus politically on the need to maintain the government’s share which, just like the family’s share, must expect to be maintained—and thus to be increased—in most years along with the underlying increasing costs of instruction and enrollments.

Common Misunderstanding 14: Finally, if a student loan program is thought to be necessary, it should be designed to be financially self-sustaining: that is, for the repayments eventually to be sufficient to cover the necessary new lending.

This is a recurring theme of new student loan program proposals, with no basis either in theory or in practice. It is extremely unlikely that repayments on past loans will ever be sufficient to become the sole source of new lending, due both to the inevitably extensive losses from defaults and built-in subsidies (which can be lessened with higher rates of interest), and also to the increasing volume of new lending needed to keep up with the combination of increased dollar needs per student and the almost inevitably increasing numbers of new student borrowers.

More important, however, there is absolutely no reason even to aspire to a *revolving* or *self-sufficient* student loan program. The amounts coming in via repayments have almost nothing to do with the amounts that should be—or can be—lent out to new or

repeat student borrowers. At its most efficient (and independent of new governmental capital), a student loan program should aspire to having the present discounted value of the anticipated stream of future payment on each cohort of new lending come as close as possible to dollar value *of those loans*—less only the government’s share of defaults plus the present value of any deliberately built in subsidies. But governments will have to account annually for the present value costs of subsidies and losses as well as any net new borrowing.

Higher education finance in any single country, and vastly more so in international comparative perspective, is an enormously complex topic, deeply influenced by particular histories, cultures, and often by the dominant political and ideological currents of the moment. These fourteen propositions listed above are complex and nuanced, and to call them *misunderstandings* may do a disservice to those who advance them and to the policies in many countries that have followed them. Each has some truth, and most have serious and thoughtful proponents. Nevertheless, I believe that there are also important elements of misunderstanding in each, and that more effective policies of higher education finance require additional discussion and alternative considerations—which I have attempted to provide in this essay.

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