CC BY NC ND

Needed: Financing Policies That Are Both Affordable and Sustainable

Arthur M. Hauptman

Abstract
Neither of the two predominant models of financing public higher education around the world manages to achieve both affordability and sustainability. Keeping tuition low provides affordability but fails to achieve financial sustainability and limits accessibility. High tuition/high aid models are more sustainable, but less affordable, resulting in more reliance on student loans. There is a consensus model that can make higher education affordable and sustainable without devoting a high percentage of GDP to higher education.

In countries around the world, there are two key objectives in financing public higher education: to make it affordable to a broad range of the population, and to make the system financially sustainable. In reality, these goals are rarely achieved. In this article, we ask whether a financing model exists that meets both objectives without devoting too large a share of GDP to higher education.

The Two Predominant Financing Models

Let us first examine the two predominant approaches. One is institution-based: Tuition is kept low relative to the costs of providing the education. Government pays most of the costs and student financial aid plays a relatively minor role. The other approach is more student-based: Tuition fees pay for a significant share of the cost and more financial aid is used to help students pay the rest.

Keeping tuition low is a politically popular approach based on the notion that higher education is a public good and taxpayers should pay the full cost of providing it. By definition, this approach typically achieves broad affordability by charging all students a very low price—although the issue of paying for students' living expenses is often not fully addressed.

But the reality is that most governments do not have the resources to provide a quality education if prices to students are kept low. As a result, the supply of seats is limited and the higher education system shrinks rather than grows. Or, spending per student is sharply reduced. Neither situation is sustainable. Notable exceptions are some Scandinavian countries, which, thanks to their high tax revenue base, are able to support low tuition and provide a quality education for much of their population.

In countries around the world, there are two key objectives in financing public higher education: to make it affordable to a broad range of the population, and to make the system financially sustainable.

By contrast, the student-based approach (also often referred to as high tuition/high aid) views higher education mostly as a private good, of which students are the primary beneficiaries because of the higher incomes that they earn after graduation. Under this philosophy, institutions tend to charge higher tuition and provide more financial aid to those who cannot afford it. The high tuition/high aid approach is far more sustainable than the low-tuition approach because it generates more revenue per student. But if the additional financial aid provided is insufficient, it leads to sharply reduced affordability, possibly resulting in a system that mainly serves the well-to-do.

In this model, the gap between higher prices and the ability of many students to pay often leads to greater reliance on student loans. Thus, loans come to represent a key mechanism for achieving greater affordability and sustainability in higher education funding. But too often, program design flaws can prevent loans from achieving these twin objectives. For example, weak controls on tuition can lead to excessive reliance on loans, resulting in an unacceptably high level of borrowers unable or unwilling to repay. This undercuts the rationale for relying on loans in the first place.

Toward a Consensus Model

One problem that limits the effectiveness of both models is that funding, fee setting, and financial aid decisions are often poorly coordinated. Another is that neither plan adequately does enough to help students pay their living expenses while in school. Is there a better way to achieve these two objectives, which could be successfully employed by a broad range of countries?

The first step in *ensuring greater affordability* is to abandon the notion that the primary function of tuition fees is to help pay institutional operating costs. Instead, countries should base tuition on what an average family can afford to pay, and build their institutions from that. For example, institutions could set their tuition and mandatory fees between 10 to 25 percent of GDP per capita. Institutions and programs in greatest demand could charge a higher percentage of GDP than those less in demand. A key component of this approach is that funding must be sufficient to provide grants to cover tuition and living expenses for students who cannot afford to pay.

This approach results in a certain symmetry. The more institutions charge within the acceptable range, the less funding their governments will have to come up with. But at higher-charging institutions, financial aid funding would need to be augmented because there will be more students unable to afford the higher charges. By contrast, for institutions that charge at the lower end of the acceptable range, the government would have to provide more institutional funding but less student aid.

The key is for countries to set realistic and reasonable limits on tuition as a percent of GDP per capita. Carefully crafted, these policies could lower net funding requirements as the reduction in institutional subsidies would more than offset necessary increases in financial aid. Under such a system, loans would return to their intended role of allowing certain groups of students to invest in themselves at a reasonable cost.

To *achieve greater sustainability*, countries must develop policies that promote relevance to society's needs, accommodate growth in demand, and achieve greater efficiency. To ensure greater relevance, the share of funding allocated to training opportunities should be increased. Many countries provide much more funding per student for academic programs than for vocationally oriented programs, including apprenticeships. Shifting more funding to vocationally oriented programs could increase relevance to the economy's needs as well as help lower spending per student, because vocational training typically costs less than academic programs.

To encourage enrollment growth, countries should use government funding to provide more marginal revenue to institutions. In most countries, government funding does not track with enrollment gains, forcing institutions to rely on student-paid fees to cover the marginal costs of any unanticipated enrollment growth. Creating a separate, government-funded fee that is uncapped when enrollments rise above target levels would mean taxpayers would share in paying for enrollment growth.

To increase efficiency, allocations to institutions should be based on normative costs. Governments or funding bodies typically rely on institutional reports of how much they spend per student to determine the allocation of funds for the future. But institutions often exaggerate what they spend. Costs could be curbed if allocation formulas were based on normative costs—that is, what "ought" to be spent per student in different fields as determined by objective data analysis.

This is a bare outline, but all of these steps taken together would help make the financing of public higher education both more affordable and financially sustainable. As a result, such a consensus model is a worthy and achievable goal for many countries.

Arthur M. Hauptman is an independent public policy consultant specializing in higher education finance issues. Email: Art.Hauptman@yahoo.com.