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Principles to Guide the Public Financing of Higher Education

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Over the past 20 years, in looking at how public funds are used to finance higher education, I have worked with officials in more than two dozen countries. While I am often asked if certain countries or states have exemplary financing systems that others might emulate, I do not believe any country or state is excellent in all respects when it comes to the use of public funds to support higher education. But a number of principles do serve to define how best to use public funds, in paying both for the support of institutions and in providing financial assistance to students and their families. Ten such principles are described below.

ELECTED OFFICIALS' ROLE

Given that taxpayers provide public funding of higher education, it is relevant that elected officials be responsible for determining how much public funding should be devoted to higher education activities. This role of deciding the amount of funding should not be delegated to bureaucrats or other nonelected officials, because it would represent a breach of public responsibility and accountability.

AN INSTITUTION'S MAJOR ROLE

The process of allocating public funds to institutions should be insulated, as much as possible, from political influences. While publicly elected officials should determine the level of public funding devoted to higher education, they must not play a major role in determining how public funds are distributed to institutions. This division of responsibility speculates that political decisions about allocations are often based more on favoritism than on merit. Thus, buffer bodies that are neither fully governmental nor totally institutional provide a rationale for determining how funds are allocated. Similarly, systems of institutions tend to be better at allocating public funds than government bodies.

INTERLINKING FUNDING, FEES, AND FINANCIAL AID

The effective policies that govern the three components to public financing—funding institutions, tuition fees charged to students, and student financial aid—often are at odds with each other. For example, how institutions are typically funded is aimed at improving quality, while student aid policies are generally intended to provide more access. Policies may work at cross-purposes. Good financing strategies should aim to align policy goals for these three-key financing components. Financial-aid policies, for example, should be tied to decisions on tuition fees. Also, decisions about allocating public funds between institutional support and student aid should be made explicitly at the beginning of the funding process, rather than have student aid funding be a residual decision, as is often the case.

FUNDING FORMULAS

These typical formulas include a cost component that is a major factor in determining how much funds each institution will receive. Most funding formulas use actual costs per student, at each institution, or average costs per student, across the sector, to calculate this cost component. But this approach tends to lead to cost escalation over time, as institutions that spend more per student receive more from the government for doing so. A formula that uses normative costs—how much it should cost per student rather than the actual cost—should lead to lower costs, as institutions have greater incentive to be more efficient in how they spend funds.

DEMAND AND SUPPLY

Fee policies should be designed to recognize both demand and supply side considerations. The traditional view is that tuition fees should be set well below costs, to stimulate demand and maximize access to higher education. But the reality is that low fees may restrict access, by limiting the amount of resources devoted to the sector, and thus the number of seats provided at any level of government funding. Also, low fees tend not to be equitable because higher-income students who constitute most of the enrolled students benefit the most. A better policy is to set fees as a share of the ability of the population, to pay these fees as measured by median family income or gross domestic product per capita. This student-based approach would also limit the adverse effect of raising fees, the most, during recessions.

INSTITUTIONS' RETENTION OF STUDENT FEES

Much attention is paid to the question of who is responsible for setting public-sector, tuition-fee levels—institutional or government officials. Much less attention is paid to whether institutions retain those fees or whether fees are sent to government for reallocation, as part of the funding formula process. Yet, in many ways, it is far more important for institutions to retain fees, so that they have incentives to enroll more students. Otherwise, they will tend to restrict enrollments if they do not receive any additional funds from enrolling more students.

GOVERNMENT REGULATION OF ENROLLMENTS IN PUBLIC INSTITUTIONS

One of the typical responses to cutbacks in government funding is for governments and/or institutions to limit their enrollments, to ensure adequate funds per student. While this notion to curtail enrollments may make sense on the surface, it violates important economic principles that suggest the expansion of enrollments until the marginal costs involved in educating more students exceed the additional revenues collected from the additional students. Rather than putting a limit on enrollments, governments should use the targeted level of enrollments as the minimum figure that institutions must enroll.

NONREPAYABLE AID

Most countries provide nonrepayable sources of aid such as grants, bursaries, or scholarships to a proportion of their students. These policies tend to serve a multitude of purposes, but they may not achieve their goals. There is also a tendency to provide aid to more students to seek to gain political favor with middle-class students. To be more effective, nonrepayable aid should be focused on students with the most financial need and/or those who are the best students. A variant is to base nonrepayable aid on both need and merit so that students, with the highest need and the highest merit, receive the largest amount of nonrepayable aid.

SUPPORTIVE STUDENT LOANS

Student loans have become a feature in dozens of countries around the world. However, few loan programs work well or are effective in meeting goals, and many also have unacceptably high rates of default. One way to improve student-loan effectiveness is to restrict its use to tuition fees and other charges and to limit or eliminate what can be borrowed to meet living expenses. In countries that lack the resources or the cultural tradition to support student loans, a good alternative is to increase tuition fees for all and then postpone the higher fees for those students who cannot afford them.

STRONG POLICY–ASSURANCE POLICIES

Financing policies often provide powerful incentives for institutional officials or students, in certain ways that will maximize the amount of funding they receive. These incentives can often lead to shortcuts, with regard to quality. Strong quality-assurance processes are therefore needed to ensure that public funds are spent wisely. The need increases, when governments do not control the operations of institutions or when aid is provided to students on a voucher basis. Thus, to curb market abuses, higher education sectors that rely on private institutions typically require more quality assurance than when public institutions are the dominant providers of higher education.

Conclusion

In sum, I contend that if countries and states adhere to the 10 principles listed above their financing systems will be more effective in meeting important policy goals for higher education.