

EU – workshop on Quality and Efficiency in Education and Training

## **Post-compulsory education finance** (some remarks)

Discussion of N. Barr & A. Kemnitz contributions.  
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### **1. The arguments of N. Barr and Kemnitz**

#### **1.1. The elements justifying reforms in tertiary education finance**

##### *A. Quantity problem (Barr)*

- *More human capital is needed* to cope with current labour market trends (technology, trade and relocation of low-skilled jobs) and the rising cost of an aging population. To put it simply, average productivity of the average active person should rise, and the necessary (although not sufficient condition) to achieve this is to increase the number of people who graduate at tertiary level.

- *Expanding tertiary education requires more resources if quality is to be preserved.* This is the logical consequence of a growing number of students but also of the so-called cost disease. Baumol would indeed remind us that productivity gains are limited within that industry. In itself, the asymmetry of productivity gains between education and the other sectors of the economy should lead – *ceteris paribus* – to an increase of the share of GDP dedicated to education.

- N. Barr judiciously explains that *current level State funding* – the main source of resources in most EU countries – *is inadequate*, partially because available margins tend to be used to serve the needs of the elderly (health and pensions) or to support basic education. The evidence is that of a constant decline in (real terms) spending per student in many EU countries.

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## B. Quality problem (Kemnitz, Barr)

Both contributors share a concern for more quality within EU tertiary education. And both papers share the view that public funding combined with central planning of provision and allocation of students leads to inefficiency of teaching.

- N. Barr's point of view is based on the idea that central planning and administered prices (uniform fees) distort the allocation of individuals and resources from their optimum. Some price flexibility should allow a *better allocation* of students between subjects (ex: mathematics departments cost less than engineering although they are equivalent in producing programming skills. Students interested by IT programming jobs should be confronted adequate price signals, and the results would be less expensive for the taxpayer).

- The view underlying Kemnitz paper has less to do with the lack of market-like signals but more with the lack of incentives for typical university institutions to *specialise* and to *concentrate resources on the elite*. His analysis mainly rests of the assumption that the return on human capital investment (teaching quality  $q$ ) is strongly affected by the ability of students ( $\theta$ ).

$$HC = \theta * q$$

## C. Equity (Barr)

Finally, the Barr paper also put forth the idea that current arrangements *are regressive*. Public financing in a context where access is still very socially biased means using everyone's tax money to finance the additional human capital of a privileged minority. There is thus a case for increasing the private contribution to tertiary education costs.

### 1.2. The logic of the reform proposed

More resources, better quality and less inequity: this triple objective can be achieved via higher and more differentiated fees.

But to avoid more selectivity or worsening the problems of socially selective access to tertiary education due to liquidity constraints, payment should be made after graduation. Equity concerns as well as risk aversion problem plead in favour of either income contingent-loans (graduates reimburse only if they earn money) or graduate tax.

## 2. Comments, remarks, critics, suggestions

### A. Loans: the response to rising mobility and free riding

In addition to quantity, quality and equity problems, there might be a fourth reason to reform higher education finance across the EU. Implementing alternatives to the current system (direct public funding) might indeed be a logical consequence of the current EU integration process. Mobility is on the rise, particularly among tertiary education students and high-skilled workers. Mobility can be asymmetric and thus synonymous of "free riding". Mobile EU students enjoy free tertiary education in one country and then move to another, escaping contribution via taxation. If unbalanced mobility is marginal, the point is not worth raising.

Otherwise the implicit contract which links them to the local taxpayer is potentially broken, unless some explicit or implicit compensation mechanisms exist (Vandenberghe, 2004).

Illustration: in the French-Speaking Community of Belgium, up to 15% of university students are potential free riders, as their final residence is likely to be outside the French-Speaking Community.

Increasing fees (and making students pay them via explicit loans contract) might simply be a way to limit the effects of free riding and ensure long-term sustainability of national (i.e. local public) funding of tertiary education, or at least to avoid the emergence of some kind of protectionism.

### **B. Raising fees... and offering deferred (and income contingent) payment options: a top priority?**

Both authors suggest that tertiary of education should be free at the point of use, which means – in a context of higher fees – that explicit or implicit loans should be offered to students. The two authors then deploy a lot of energy examining the merits of the different ways of implementing these loans as well as their repayment by individuals. In we refer to N. Barr's paper, we discover that loans should be income-contingent. These mechanisms are relatively difficult to implement (they require some knowledge of income levels) and require a public subsidy to eliminate the relatively high risk-premium that is attached to human capital investment (by comparison with housing).

The question I would like to raise is whether is totally relevant to focus on student loan design (Barr) and their probable effect on the functioning of universities (Barr & Kemnitz).

I am perfectly aware that higher fees without income-contingent loans or any other deferred payment scheme is a political suicide in most EU countries. But as an academic I wonder whether is absolutely relevant to put so much emphasis on these mechanisms. In other words, why do we need to care so much about postponing the payment of higher fees? What do we know about the (instantaneous) price elasticity of the demand for tertiary education, globally and for low socio-economic groups in particular? What do we know about what economists call the intensity of the liquidity or credit constraint?

- On the one hand, Heckman & Carneiro (2003), examining US data, suggest that this elasticity is relatively low, even among low SES groups.

"We find only a limited role for tuition policy or family income supplements in eliminating schooling and college attendance gaps. At most 8% of American youth are credit constrained in the traditional usage of that term"

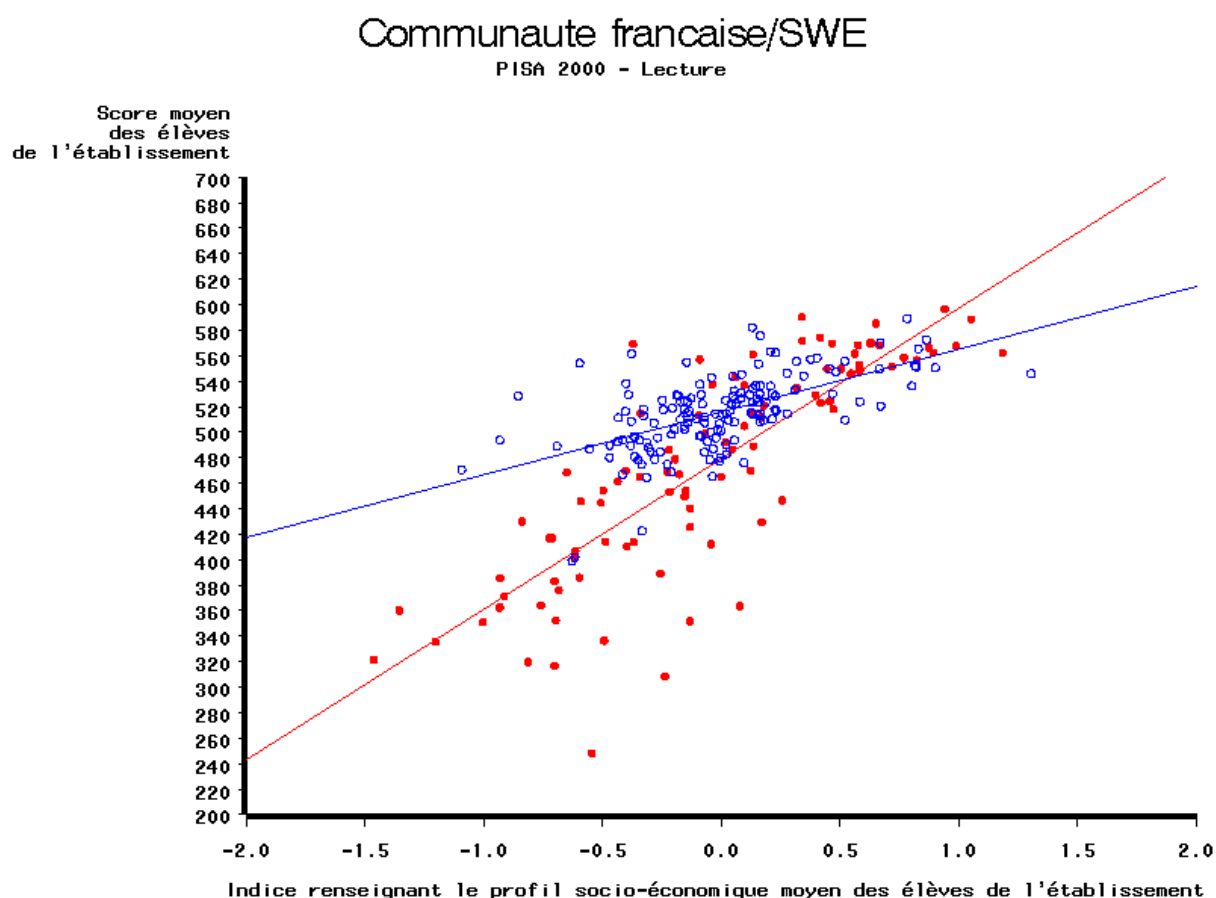
- On the other hand, the evidence in many EU countries is that the traditional payers of all costs that are not covered by public money (fees and living costs) are parents. But even if their capacity to pay can be increased, it could be that policy -makers should no longer take for granted that all students (even those from rich families) will enjoy the benefit of their families' wealth. Should we still assume that most young adults aged 20-24 are still supported by their families? Or should we adopt the view that they must be considered as totally independent? If the latter option prevails, then the liquidity constraint should be received a lot of attention.

### C. Liquidity constraint or basic knowledge constraint?

The Heckman & Carneiro (2003) result can be interpreted as an indication that the problem of low SES individuals is not primarily a lack of financial resources to cover fees and living costs. Yet, it is still the case that many low SES individuals never show up at the admission office of universities. One reason for this is simply that they don't possess the right level of basic skills.

The latest OECD survey of literacy levels at the age of 15 gives a good illustration of this idea. According to the pedagogues who designed PISA any score below 450 should be interpreted as a sign that students do not properly understand the meaning of a text. If you make the (fairly reasonable) assumption that being able to decipher a text is an absolute prerequisite to successful tertiary education, then you end up with the conclusion that offering income contingent loans as a way to mitigate the effect of higher fees is likely to have no effect for all those whose real constraint is a lack of literacy skills.

As an illustration, we take the French-Speaking Community of Belgium and Sweden. Access to university is significantly higher in Sweden. But both Belgium and Sweden rely mainly on public funding to cover teaching cost (i.e. fees are low). So the explanation of the gradient in access rates has probably little to do with financing mechanisms. We would suggest that it has more to do with the rather higher(lower) efficiency of basic education in Sweden (French-Speaking Belgium) to ensure that low SES pupils score above the 450 score at the age of 15.



#### **D. Loans and admission/selection mechanisms**

With respect to the implementation of student loans (from the supply side), *the selectivity at the entry* to higher education institutions could be positively perceived as reducing the academic risks related to the completion of a degree. Indeed, although there is an important uncertainty in predicting which students will obtain high-ranking jobs, the success to admission exams is a useful predictor of the students' subsequent job placement, reducing in parallel the likelihood of non-repayment of the loan. In other words, the introduction of loans mechanisms would probably lead to a generalisation of selective admission mechanisms.

Another way of reducing the academic risk (i.e. risk of failure/drop out) would be to implement loans at the Master level, maintaining the current system of funding for the Bachelor degrees.

#### **Bibliography**

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