University of Cape Town submission on the future funding of higher education

1. Preamble – Endorsing points made by Universities South Africa

I want to start by endorsing the analysis of the context in which this policy review is taking place which is explained in the submission made by Universities South Africa, to which UCT contributed, and which I will therefore only name here without elaborating. These are:

- the role and importance of a vibrant higher education sector in any country, but especially in a developing knowledge economy such as South Africa.
- the huge success of the SA higher education sector over the last 20 years, in quantity, quality, equity, diversification, growth of STEM graduates, and improved access through the growth of NSFAS
- the poor performance of the school system results in the universities having to invest heavily in supporting underprepared students and still experiencing high rates of non-completion, which is clearly an inefficient use of resources
- the challenge of chronic underfunding which has resulted in high fees to compensate partially to keep the universities afloat, and this in turn has rendered university education unaffordable to many and in recent times, has created the risk and reality of instability in the sector
- the higher education price index at UCT has, consistent with the USAf submission, run for many years at about 2% above CPI. This needs to be taken into account in funding higher education. One factor is that salaries increase slightly above inflation while productivity in teaching has hardly increased over the years. One might argue that salaries should be kept at CPI under these circumstances but the market for academics and non-academics in which we are competing to attract and retain staff, is the local and international private sector, and public sector, in which salaries have been rising at well above CPI for many years. Other factors contributing to the higher inflation rate are the extent of imported goods and services, and utilities.
- the CHE calculation that in 2014, SA government expenditure on higher education was 0.64% of GDP; the CHET calculation for 2012 was 0.76%. The appropriate target for a country like SA would be about 1% of GDP – halfway between the expenditure levels in Brazil and India
- Block grants per student (teaching input units and teaching output units) have been negative in nominal and real terms
- Minimum wage increases for lowest paid workers, with or without in-sourcing, has created a stepwise increase in the base level of funding required to continue operating at the same level as pre-2015.

2. Ideal position unconstrained by resources and rationing

In an ideal world, if SA were a rich country with little inequality and was already providing sufficient state funding to support socio-economic rights such as universal fee-free quality primary and secondary schooling, universal access to Early Childhood Development centres, Health Care, social welfare support for all elderly and unemployed – we would support a system of no-fee higher education. A medium term plan, however, for the next 30 years, will have to fit a different context, of significant inequality and rationed public resources in which fee-free higher education cannot claim to be the highest priority of all.

We therefore argue that for the foreseeable future, higher education should have 2 main sources of funding – government grants and tuition fees.

3. A detour through the consideration of "third-stream income"

Before returning to argue this view of two sources of funding, I want to comment briefly on "third-stream income". This refers to a combination of different sources – but the key common element of these resources and also the reason why third stream revenue is not being considered further in this submission, is that in general, third stream income is raised for specific ring-fenced purposes and cannot be used for the general operation of the university. In general, the activities funded through third-stream income would not be undertaken by the university in the absence of that income. Moreover, it is variable, unreliable, and by contract needs to be used for the purposes for which it is raised. For example, at UCT, about 50% of total revenue in the university's income statement, some R2,5bn is income generated from outside bodies, often outside the country, for specific research projects. If the money is not raised, the research will not be undertaken. And the money cannot be used to fund instruction or any other core university expenditure. Another example is endowments specific to funding a professorship in a discipline or a bursary or a prize. These funds do not defray the costs of the core business of the university. In SA, so-called "free endowments", the icome from which may be used for general purposes, are small. At UCT, the free endowment of about R500m generates an annual income for UCT of R20m (after capitalising an amount equal to CPI). This R20m is 0.6% of annual income from tuition plus subsidy.

4. Why is it necessary and desirable to include co-funding from fees?

Co-funding is not intended to diminish the imperative for increased government funding (hereinafter referred to simply as subsidy). As indicated above, subsidy is inadequate, and regardless of the extent of co-funding form fees, subsidy should be increased ideally to about 1% of GDP to reflect the public good that derives from higher education, especially the benefits of research and innovation, and that exceeds the sum of private goods that payers would be willing to purchase. However, the point here is that even with improved subsidy, co-funding desirable for the following reasons.

4.1. Fees enables the system to generate more funding for Higher Education than if there is only government funding. Government funding is limited in SA and even if it were to increase to 1% of GDP, this would not be enough to replace current revenue from fees, nor to ensure that the quality and growth of the higher education systems was adequately funded. Yet there is a public out there willing and able to pay for a good education as illustrated by current practice and by the spend on private schools at rates much higher than university fees, or to send their children to private universities and overseas study. This is additional revenue that would come with University system that is lost if universities are not allowed to charge fees.

4.2. The balance of private and public goods: Universities generate a direct benefit to the future graduate in terms of probability of employment and level of income – what economists would call a “private benefit”. This is in addition to a public benefit from generally more educated population, doing research that benefits society generally - which must be publically funded. Hence the co-funding model. Even currently poor people will benefit personally from university education in ways that those who do not go to university will not, through higher rates of employment and higher incomes as a result of their education. Thus everyone who benefits from higher education should be expected to contribute towards this preferential benefit. While most will not have the resources to contribute at the time of studying, they can pay back some part of that investment through income-contingent loans once they start earning.

4.3. Fairness: Tax based public funding should benefit all, and not just a small proportion of the population who are likely to be the most privileged. Higher education is only accessible to about 20% of the population and a much smaller percent of households, and even though this should increase to about 25% over the next 20 years, this is still a small minority of the population. Furthermore, this 20% is already relatively privileged as evidenced by the fact that they have been to better schools and come from family backgrounds that have enabled them to succeed academically. They will also become even more privileged relative to the rest of the population as a result of their university education. This is unlike public funding for schooling or health, which will benefit 100% of the population if everyone chose to use the public schooling and health systems. Thus everyone is paying tax (e.g. through VAT, duties, and for many, income tax) while only a small proportion who are already relatively privileged, benefit.

4.4. Regressive use of public funding: Free higher education implies that the state is investing not only in the public goods from higher education – the benefits that private individuals will not pay for – but also for the private benefits of higher education that accrue to the individual households. This is permissible if the public funding also has a redistributive effect (for example child care grants are for private benefit but are redistributive). Free higher education, however, does not differentiate between those who can afford to pay and those who can’t and provides equal benefit to rich and poor. It is in fact regressive, generally benefitting the rich much more than the poor.

4.5. Fees are a central driving mechanism for the differentiation of the higher education sector, particularly the funding of research universities. Current government funding strategy gives all universities the same amount of funding for the same number of students weighted in a standard way for the costs of delivering different study programmes. Research intensive universities are more expensive than the average university, and have been able, up to now, to cover their higher costs through higher than average fees. Unless government were to change its funding strategy dramatically, to allocate research universities a significantly greater share of the national pie, if there were no fee income, the research universities would collapse – or rather, they would no longer be able to compete globally as research institutions, and would also then lose their ability to attract top research staff, top teaching staff and top post-graduate and post-doctoral students.

5.

6. Ensuring financial access

Equity requires that in a system that relies on fees for co-funding, “the poor” should have equal access and affordability should not be a barrier. Of course society does not divide into the poor and the rich. The continuum of income determines a continuum of affordability. We use the term “lower income” to refer to that group which may have no income or an income that still renders full fees unaffordable. The extent of financial support they require will of course vary.

Three ways to achieve this:

- Free education for the very poor, mid-level fees for lower income households and higher fees for the rich.
- Bursaries for lower income
- Loans for lower income

Challenge of free for poor and sliding scale fees for lower and middle income students is the difficulty of administering a system with multiple fees for each course, (cost of residence, food, books etc). If there were only 2 levels of fee – free and full fee, the income threshold that determines whether one’s tuition is free or at full fee would be unfair to those just above the threshold who might be relatively poor compared to the rich, but still have to pay the same fee. And those just below the cut-off would get free education like the poor, though they would in fact be able to afford a contribution. The highest level fee that could be charged would have to be kept quite low. What we really want in terms of fairness and optimising revenue is a sliding scale. This would mean multiple fee levels for each course. What about books, or food in residence? Would there be multiple fee levels there – depending on income? And then if a student stayed out of residence and buys their own food, clearly a grant system is needed anyway to support their ability to pay for food and accommodation and books. So we cannot get away from a financial aid system that distributes bursaries or loans. A simpler, fairer and more efficient solution is to have the same tuition fee for everyone, just as all students face the same costs for books and food, and ten provide personal bursary support for those who need it on a sliding scale.

7. Should the Financial Aid be a grant or a loan?

There are several arguments in favour of a loan system.

7.1. First and foremost, this returns money to the system and reduces the fiscal burden, or alternately, allows more money to come into the higher education system. For example we are currently only funding undergraduate education – additional funding would enable this to extend to post graduate in future.

7.2. Second, already stated above, the private benefits for all, rich and poor, are significant and if only a small proportion of the population is benefitting and other much larger sections of the population, are in effect not being funded because of the opportunity cost of this use of public funding, then this is inequitable.

7.3. Third, the system currently generates significant funding from private sources, both corporate – who wish to support students that may in future come and work for them, and philanthropic. See the current UCT sources of funding. If there were no fees, or fees for lower income students were pure grants, there would be no incentive for these third party funders to contribute to the funding of higher education.

7.4. A loan system is more likely to be able to draw on private sources of capital. The banks and pension funds could never be expected to donate to a financial aid scheme, but could be expected to make loans, structured and leveraged through underwriting by the state or partial grant funding so that the returns and risks were competitive with other markets. Thus the use of loans enables government to share the burden of capital and cash flow in funding higher education.

The key arguments against a loan system and their counter arguments:

7.5. Loans penalize the poor. The rich (at the time of being a student) don't need the loans and will graduate debt free. The middle income will need loans and will graduate with some debt but they are already the beneficiaries of a system which has provided their parents with jobs and some resources. The very poor, with no family income, would graduate with the maximum debt, have the highest risk of drop out and thus ongoing debt if they cannot find decent employment, and therefore the slowest to break free of their class backgrounds. They are in a sense being doubly punished for being poor. This may be an argument in favour of a part loan part grant or even a full grant for the very poor as part of the redress argument. There are more factors to consider regarding a total grant which are not elaborated here – such as evidence that the prospect of a loan rather than a pure grant focuses attention on issues such as probability of employment and income given different qualifications; minimizing the time spent completing a degree.

7.6. A commercial rate of interest and no conversion of loan to bursary naturally raises concerns about trapping students from poor backgrounds in a debt-ridden situation. However, it is crucial to distinguish between good debt and bad debt here. Debt is bad when (a) it destroys your credit rating and (b) it risks creating a situation in which you have to make repayments which you can't afford. Student loan systems can and have been designed so that they do not create bad debt. First, credit ratings agencies should not count manageable debt to the government for university study as diminishing your credit rating like credit card debt. But second, and more important, the student loan scheme is designed so that the interest rate does not determine the rate of repayment. Loans with income-contingent repayment are guaranteed to be manageable, because when you are not earning you are not required to make any payment, and the payment per annum is always a manageable proportion of your earnings. When someone does not achieve high earnings after university study, they never have to repay, so in this situation it is as though there is no debt at all. And the government as the most credit-worthy institution in society has the ability to ensure that debt in this area is exclusively of the good variety. Income-contingent repayment actually realises Marx's principle: you consume HE according to need (smoothed by loan), and then you contribute to the costs according to your ability to repay the loan.

In summary, we support co-funding of higher education from subsidy and fees. The government subsidy must rise significantly (at least 30%) to bring it closer to benchmark countries spending 1% of GDP. The increase in fees should bring in additional income into the system and to certain universities, and enables those universities to fund themselves above the national average in order to conduct research and post-graduate studies – which are seldom adequately funded from subsidy. Although fees could be set to zero for the very poor and lower income, and set high for the wealthy, the difficulty of administering this multiple fee level system for different levels of income is too complex. The same goal can be achieved far more simply and efficiently by offering grants to the very poor, which covers their total fees and thus effectively creates fee-free education; part grants but mostly loans to the missing middle; and charging higher fees to the wealthy.