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Title: Financing Higher Education: Analysing dissimilarities in available subsidies as a Public Good.

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Abstract

Methodologically this paper is based on a secondary survey of the literature. This paper intends to look into the debate on public subsidies in higher education and rising inequalities. Furthermore, it talks about the classification of higher education as merit good, public good, quasi-public excellent or private good. Then investigating further rationale of state intervention and finally by evaluating various sources of finance and arguments on inequalities, and concluding analysis based on literature review as whether public subsidies are accentuating differences or will it be the case that in the long run, the social rate of returns for higher education will address the issues of short-run inequalities in developing countries.

Keywords: Finance, Higher Education, Dissimilarities, Subsidies, Public Good.

1. Introduction

"By the end of the 1980s, higher education in India has become one of the largest systems in the world, with about 10 million students enrolled in 188 universities and about 14 thousand colleges and with 400 thousand teachers. More than Rs.10 thousand million are invested every year in higher education, which forms 0.9% of GNP. Nearly one-third of the total education budget goes for higher education with about one-twentieth of the total student population in the country. In a developing country like India where universalisation of elementary education still eludes, and mass illiteracy is dominant, how is higher education financed? The paper discusses the pattern of financing higher education, the weaknesses therein and some alternative policy choices available for improving the financial situation of higher education, with least ill effects on equity and efficiency"

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Conceptual and policy issues relating to subsidies higher education in general (and not just in India) face an analytical understanding: any discussion on such an item has to begin by acknowledging that from a policy point of view it is not easy conceptualising what "good" higher education means, and therefore what kind of regulatory framework is appropriate should resort.

The pricing of higher education and the actual extent to which it can subsidise rests on the basic understanding of the nature of higher education as a good. However, lately, higher education is regarded as public good producing massive sets of positive externalities out reaching society. These are those institutions which increasingly recognised as vital social institutions covering an as diverse aspect of humanity as political, economic, cultural, social and technological.

2. **Education as a good:**

Taking higher education as a case for the pure public good, is a refuted notion as the two prime characteristics of public good: Non-rival consumption and Non-excludability not fulfilled in case of higher education. According to Musgrave and Musgrave, merit good defined as a good which is so worthy that emits positive externalities. Thus on account of the arguments resting based on the emission of positive externalities, higher education is seen as a merit good, it said to be identified as non-merit as it defies entire body of empirical evidence and endogenous growth theories that it does generate substantial externalities and influences growth.

Thus redefining education as mixed good or quasi-public good because, it is said to be a blend of private good and public good as it is demanded privately by students whereby the benefits occur to them and it then being rival and excludable and on the other hand it shares the features of public good, benefiting society through externalities.

3. **Logical deductive for State Intervention:**

A Case for an Economic reason:

The economic justification for the existence of the state can be deduced from the Pareto criterion. It said that if an individual move from superior equilibrium through which an individual can reap extra benefit at the expense of the society, is not conducive for the economic welfare as a whole whereby calling the establishment of an order.

An order which can guarantee that superior equilibrium implies that an agency may be established which can effectively prevent individual or groups in society from leaving the social optimum, from ensuring that such moves will not occur which is the sufficient condition for the stability of the order. It comes out to be the economic rationale for the existence of an order, i.e. the state more generally for the production of collective goods or goods like education.

Hicks, also maintained that the welfare optimum in the presence of market failure had to be attained by Govt. actions. The economic value of higher education emphasised in various theories which underline the importance of state undertaking such a sphere under its supervision to promote growth and development.

Be it education as a human capital approach to raise productivity or as a screening device to identify ability or as a means of building up of social capital by inculcating socially acceptable norms and behaviours, investing in higher education remains subject mainly of public domain.

4. **Influence for the Intrusion of the State: Externalities**

Some benefits of education are said not to only confined to the individual as a recipient but to society as a whole. For example, educated society sees benefit in terms of controlled fertility, better health, doing away with social evils. Now in such a case, it is although an individual's own choice as to how much to consume as in terms of education but at the level of the society as a whole, we need to encourage consumption of education as a good for the wellbeing of others. Thus calling for the private provision or for that matter full cost recovery especially in developing or the underdeveloped countries will result in under-provision of education on account of market failure, free-rider problem and problems emanating from preference revelation.

4.1. Merit goods:

Provision of products such as health and education are relatively critical for the development of a nation and therefore considered to be so commendable that their arrangement called for in public budget.

4.2. Leads and lags:

"The nature of higher education is such that it involves a long gestation period. The perverse effects in the market than can be explained with the help of the cobweb model sometimes resulting in oscillations diverging from equilibrium because the market signals for higher education may be slow to change"2

4.3. Economies of large scale production:

It is the very nature of the higher level of education in terms of infrastructural requirements such as large laboratories, libraries, medical, engineering and physical sciences faculties which need a reasonably sized population of students to make it a viable unit.

In underdeveloped countries or developing countries, undertaking such a task can be accomplished if state behaves as a provider of such a service by acting as a monopolist.

4.4. Equity :

The private purchase of schooling and especially of higher education and training is beyond the means of poverty-stricken masses or poor households in LDC's. The private provision of education would lead to greater efficiency and equity costs hampering the overall welfare. It's also argued that efficient credit markets also do not provide solution owing to imperfections outside such markets which further reduces participation.

Besides these arguments, out of the returns from education, a small fraction of it occurs to parents who then might have reasons to under invest in education and realisation of high economic returns will not be possible. There exist social-cultural biases which deter the access and participation of students across the nation.

5. **Problems about financing higher education: issues with public subsidies:**

The present scenario of higher education has invited challenges questioning the subsidies in higher education on various grounds. The advent of 1970 was a period of crises across the world, whereby factors such as high rates of inflation, shrinking public budgets for education and a lot more.

George Psacharopoulos in his paper the perverse effect of public subsidies argued on the diverse ground that free education is likely to have the opposite effect to the one advocated by politicians as it may further aggravate than alleviate social disparities.

The main reason for such perversity being that though the education may provide at highly subsidised cost at the university level, enrolments have to be rationed by non-price means like competitive examination because of supply-side constraints in the form of limited universities. The resultant non-price allocative mechanism is inequitable because it favours students from well off families who can afford the substantial direct cost of special preparation for university entrance exams. The paper also demonstrated the reasons as to why the educational pyramid in developed countries differed from that of the developed countries.

In case of developed countries the broad base, is on account of the fact, that these countries have achieved nearly 100% enrolments ratios at the primary levels and are keen to go up the educational ladder. Broadly on account of not the minimum schooling laws but also the stock of highly educated parents who are driving force behind pushing their children to acquire at least as much education as they have. Therefore the social demand for education perpetuates itself from generation to generation. The narrow base for LDC's is on account of several reasons acute supply constraints at primary levels, population growth, socio-cultural taboos, the vast opportunity cost of higher education and a limited amount of resources to make expansion at the tertiary level. They are therefore resorting to a policy measure whereby a combination of the discriminatory charges can use in higher education in terms of the payment of the full cost by the students from high-income families. Such inequalities in education have also been explained on the demand side by referring to two kinds of student.

a) Applicants, who have gone successfully through the school system up to the end of a second cycle and they are the ones expressing the effectual demand.

b) Entrants, these are those who eventually survive the selection process and finally enrolled in the first year of university.
The measure of imbalance then given in terms of the ratio of the entrant to applicant plus the frustrated aspirants

It is in the absence of the charges the ratio of aspirants to the entrant's increases which further aggravates the gap between the demand on one side and a nearly fixed supply of the university places on the other side. Such a situation creates a further need for non-price restrictions to the entry and thus creates a spiral of social unrest. Such a myopic view of demanding free education in monetary terms and ignoring the unequal entries on the part of the state has a robust political economy behind it. Due to such measures, high-income households get to have a free ride (a boast to their real incomes) relative to the less advantaged groups. Yet another cause observed for unsatisfied demand for university places, being a potential cause of promoting inequality is due to factors beyond Government control, like the shape of the educational pyramid and the market conditions for graduates and also due to the Governmental policy of providing higher education free of charge which has a robust political economy behind that.

6. **Towards exploring alternative sources of finance:**

The scepticism concerning subsidies in higher education given the constraint relating to the public budget, market imperfections, equity issues, sustaining a knowledge economy in the globalised world calls for exploration of other potential sources of financing higher education. Also because not all kind and levels of higher education emit externalities, making a case for quasi-public good along with supply-side bottlenecks, graduate unemployment and distributional objective, there is acute need to evaluate different measures to finance education.

6.1. User charge proposal:

Favoured primarily on account of the understated grounds, it provides strong arguments for efficiency and equity. It argued such a fee is a promise of realising higher returns in the form of high income in the post-education period. But it is to be seen that in the case of developing countries, the certainty of the top future income stream is there. Ironically the case for LDC's, because of supply-side bottlenecks, the poor state of the job markets, uncertainty turns out to be very high.

In skill scarce economies, there are risk factors such as education dropouts, technological redundancy etc. that stands stiff in contradiction to the efficiency equity argument. Also, because of distortion in education in educational investment decisions occur when time preference of parents and children do not match. When it comes to operational feasibility, the underlying problem of such an approach is to calculate the per-unit cost of education. Resorting to discriminatory pricing as advocated by George Psachropolous, would though answer the equity requirement but practically resorting to such a mean is difficult in developing countries.

6.2. Subsidy tax proposal:

The proposal calls for the introduction of subsidy offsetting surcharge on personal income tax: of individual beneficiaries as according to their life cycle earnings. But the plan calls for the recovery of subsidies later besides continuing with the present public expenditure. Given job market constrains and uncertainties and the long gestation period that higher education commands such a method of finance cannot prove itself as a substitute for the subsidy problem. Moreover, the differential fee structure, if adopted for different courses, will further tend to aggravate the equity issues as only those who are rich will be going for high paid courses.

6.3. Educational loans:

As human capital approach advocates that because the students(investors) are prime beneficiaries of higher education, they should finance themselves. But given the asymmetry of information, least developed capital market in the developing countries, this mode does not cater to the problem of equity. Knowing student's financial status in an LDC's and the challenge of collaterals along with the repayment risk questions the viability of the option.

6.4. Income dependent loans:

Proven to be successful in some of the developed economies, the uncertainties related to the job markets about many bottlenecks in the LDC's deters this mode of finance further on account of general issues such as interest rate, way of collection etc.

6.5. Graduation tax:

It is a tax which is in addition to the general income tax, which imposed on graduates. Besides distorting the tax structure, adding to tax compliance, rise in administrative cost the graduation tax becomes a disincentive to pursue higher education for the students obtaining degrees from the private aided institution by paying user charge fee.

6.6. Educational vouchers:

Hence foster equity objective and the educational voucher advocated because they make students directly entitled and not the institutions. Thus proving to promote equity, efficiency objective, by providing for flexibility in terms of allowance to vary concerning the cost of different courses, socio-economic background or for that matter to encourage a particular direction.

It is also said to provide healthy competition between funded public education and private funded education and also ensures transparency. Due to the high cost involved in higher education, such vouchers are not advocated for higher education and remain confined to primary school.

6.7. Self-financing market-determined courses:

The option for self-financing for market-determined courses is a skewed approach towards dealing with the problem of subsidies. Though market-determined courses leave other potential courses. Resource generation resorting to market will **severely** hamper the research undertaken; therefore, research being a critical area for development; it should rest in the hand of the state.

Besides measures mentioned as above, Tax financing is least advocated for LDC's because it often said that the nature of taxation in such countries is highly regressive and therefore is the prime force contributing to the problem of rising inequalities.

The share of direct tax (the ultimate burden cannot shift) to the indirect tax (responsibility of the charge can change) stands reasonably low. Those who enter finally to pursue higher education are form wealthy affluent class at the cost of tax paid by non-entrants.

7. **Conclusion:**

The nature of subsidisation if seen in terms of catering to the better-off section of society and restricting subsidisation in wake of dealing with the problem of graduate employment (by reducing demand) or because social rates of returns from higher education is low as compared to the private rates of returns, is no solution to the problem of rising inequalities due to subsidisation or to deal with highly constrained budget for higher education.

The considerable disagreement over the social rates of return in Higher Education as per the World Bank report has two contrary arguments as pointed by Pratap Bhanu Mehta and Devesh Kapur. Such confusion over this issue reflected in World Bank reports on this issue (Higher Education: The Lessons of Experience, 1994 and Priorities and Strategies for Education: A World Bank Review, 1995). To quote as to reflect on the confusion and obfuscation in the 1994 report is as under:

“Indeed, it is arguable that higher education should not have the highest priority claim on incremental public resources available for education in many developing countries, especially those that have not yet achieved adequate access, equity and quality at the primary and secondary levels. It is because of the priority these countries attach to attain universal literacy; because the social rates of return in investments in primary and secondary education usually exceed the standards of performance on higher education and because investment in primary school can improve equity because it tends to reduce inequalities”. (World Bank, 1994, p.3)

Ironically, the executive summary of the same document reads:

"Higher education is of paramount importance for social and economic development. Institutions of higher education have the primary responsibility for equipping individuals with advanced knowledge and skills required for positions of responsibility estimated social rates of return of ten per cent or more in many developing countries also indicates that investments in higher education contributed to increases in labour productivity and higher long term economic growth essential for poverty alleviation". (World Bank, 1994, p.1)

Thus there is a need for the governments to take the appropriate allocative decisions. For instance, as revealed by the literature, allocative decisions in India have, by and large, not been governed by any serious debate over this question. They are rather determined, by political economy considerations. While recognising the difficulty of this question, any sensible public policy ought to be able to justify its allocative priorities on rational grounds publicly.

Moreover, in the underdeveloped economy due to market failure, parents are not able to comprehend the benefits of education. To view benefits in monetary terms in the form of high pay packages is not the sole concern for developing economies. The finance can, besides subsidies, be supplemented by increased allocation for scholarships based on merit as well as other socio-economic consideration. Because of the sequential interdependence, on account of budget constrain, spending more on elementary education as compared to higher education stands unjustified. Therefore in knowing the underdeveloped nature of credit markets, asymmetry of information, keeping an edge in the global knowledge economy and for economic development, issues about subsidies must examine on rational grounds.

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