

TENTH INTERNATIONAL CONFERENCE ON HIGHER EDUCATION

KEY ISSUES IN UNIVERSITY FINANCING

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1. Introduction

Higher education finds itself today in virtually all industrialized countries in a real bind. Resources devoted to higher education have been steadily declining in the 1990s, while demand for well educated citizens, those who can help solve ever more complex social, economic and political problems is greater than ever. This is a real challenge for those financing higher education institutions (governments, firms or individuals) as they should not neglect long term benefits; but it is also a challenge for universities and other tertiary education institutions as they have not only to find additional sources of income but also to improve their efficiency and take advantages of new promising opportunities.

This short survey of the key issues in university financing will be divided into three sections :

- The context of university funding
- The economic foundations of university financing
- The four main sources of income generation : the State, other state entities or bodies, the students and the private sector.

1. The context of university funding

The increased pressure on university financing is due to two contradictory trends : an increase in the services expected of universities and a stagnation, or even a drop, in the financial resources at their disposal.

Without going into detail, let us recall that the growth in demand is mainly due to the following reasons : an increase in the proportion of young people wishing to go on to university, the need to develop post-graduate training or lifelong learning to meet the requirements of the labor market, the need to offer new courses and start new research, the need to keep up with scientific developments; hence, the obligation to renew increasingly sophisticated scientific equipment as it becomes obsolescent or in order to meet safety and environmental protection standards.

The increase in financial pressure springs from two causes, external and internal. Externally, universities cannot escape the consequences of globalization in the world today and the atmosphere of stiff competition that this creates. For universities, like private enterprises and state entities, financial resources are harder to obtain because competition from other activities is stiffer and everyone (companies, state bodies and tax-payers) is controlling costs more rigorously. Nor can one hide the fact that, in certain countries, universities suffer from the increasing tendency of decision-makers - especially of public authorities - to pursue short-term

goals.

Internally, universities are exposed to upward pressure on their unitary production costs, for at least four reasons :

- because their services are based mainly on labor,
- because their human resource management is not flexible,
- because they are facing increased competition from the private sector, which is searching for talented specialists,
- and because they have often not invested enough in expensive technical rationalization tools, even though the cost of computer hardware and software is on the decrease.

There is every reason to believe that this situation will continue for a number of years to come. Therefore, universities must also question themselves and take strong, sometimes courageous, measures on both the expenditure and the income sides of their budget.

Although this address is focused on university financing, one should not neglect that an improvement with which tasks are carried out constitutes a not negligible source of supplementary funds to develop new services. In other word, on the expenditure side, universities have to make a great effort to restructure, in particular, to adapt faster and better to society's expectations, better select their services, share tasks among different universities or higher education institutions, enhance the efficiency with which they produce their services and, finally, improve transparency in terms of teaching and research activities. Furthermore, they have to reinforce decision-making structures and to improve flexibility.

2 The economic foundations of university financing

While the problem of university funding goes far beyond the field of economics, economic sciences help us to ask the right questions and formulate the right strategies. What it teaches us hinges on five theses¹ .

a) Spending on education is an investment (in human capital) and is profitable as much for the individual as for society; some consider that investment in human capital is even more profitable than that in physical capital. As a factor of productivity increase, education spending contributes to economic growth and development.

b) It is necessary to draw a distinction between university services directly geared to the individual (economists talk of **private goods**) and those geared to the community (**collective goods**). Roughly speaking, one can claim that **fundamental research** is a collective good, while **lifelong learning and applied research** are very largely private goods. As for **basic and specialized education**, it has the dual status of a private and a collective good; it not only directly benefits each student but also other citizens, who draw indirect advantage from the work done by students. In other words, the studies undertaken by some produce **external benefits** for others.

c) University policy cannot be based on the sole criterion of economic efficiency. **It must also provide for equal access to higher education**, whatever the financial status of the family. In other words, anyone capable of studying at a university should be able to do so, and should

¹ See, in particular, F. Thys-Clément, *The crisis of university financing, speech at the CRE 44th bi-annual conference in Aarhus, the 17.5.1995.*

even receive positive encouragement, irrespective of their financial situation. This is all the more important given that economic efficiency and social justice could, in the case of education, well be complementary.

d) From an operational stance, it appears that education and continuing education services, as well as many research activities, can be provided either by public or private institutions. In the first case, most of the funding comes from public authorities; however, the institution may also levy tuition fees or sell certain services. It may even be that if the State has decided to finance the student directly instead of indirectly subsidizing the university (the educational voucher model), tuition fees account for most of the institution's resources. Conversely, private institutions often receive substantial aid from state entities, in particular because the latter endeavor to reduce financial barriers to access. Institutions also benefit from indirect subsidies when students receive a study grant, a scholarship or a state loan. Therefore, when dealing with university financing, it is preferable, in order to avoid confusion, to speak of public or private **funding** as opposed to public or private **institutions**.

e) the **price mechanism** is the best known system for allocating scarce resources. It has a positive impact on both supply and demand for university services.

- On the **supply** side, the sale of services for a price (fees) has two advantages : on the one hand, individuals are encouraged, as a rule, to pay greater attention to the quality of the services received when they have to pay for them (poor quality universities are in danger of losing some of their customers and therefore their sources of financing); on the other hand, it helps to prevent excess supply, a source of wastage.
- On the **demand** side, young people are, in theory, encouraged to weigh more carefully their decision to undertake further studies in a given field.

3. The main sources of income generation

We can clearly identify four main sources of income generation. It nonetheless goes without saying that, depending on the specific context of each university, certain sources are more important than others, or offer a better potential for increased income than others. Therefore, it is up to each university to find the best possible combination to generate additional funding.

3.1 Income derived from the main funding public authority

As a political body, the main funding public authority is naturally concerned with the political "profitability" of its decisions. In a highly media-oriented era that pushes for quick political results, the long-term efforts required in higher education and research may be at a disadvantage compared with other projects that are politically more "profitable" in the short run. Therefore, universities and all those convinced by the extremely important role played by higher education institutions should act to raise the interest of the persons representing the supervisory authority (ministers, parliamentarians and civil servants).

The subtlety of this strategy hinges on the ability to convince the funding authority of the appropriateness of chosen policy while preserving a maximum degree of independence during implementation. As supervisory authorities are often tempted to keep a detailed check on the use of additional means made available to a university, it is of utmost importance to convince them that a decentralized management system offers obvious advantages in terms of staff motivation and flexibility adapting to the environment, particularly in a university.

From the practical standpoint of budgetary techniques, it is necessary to break away from the routine whereby the budget of a university and its sub-divisions is set without much relation to requirements and programs, basically in light of the situation of the financial provider. Likewise, to provide for the indispensable flexibility in management, it is advisable to avoid establishing itemized budgets which usually also ban transfers from one item to the other during the financial year or from one year to the next. People have now realized that supervision of public expenditure carried out on this basis by parliament is largely illusory as budgets and accounts are presented more in keeping with accounting and political criteria than with public policy and sound management. Instead, it is preferable to grant a global sum that covers all expenses incurred by the university and to check achievements against intent. Block grants make the beneficiary institution feel responsible and focuses political discussion on the real issue, that of policy objectives and means.

In any case, the block grant model means that it is then the university leadership that must take unpopular decisions, and internal decision-making structures should allow this.

There are doubtless different ways of creating transparency in the institutional policy envisaged. A constructive solution consists in drafting a multi-annual plan spelling out the goals, fields developed and reduced, even suppressed, and describing the means required to achieve these ends. The multi-annual plan, as an instrument of persuasion, nonetheless remains the fruit of a unilateral act by the university. The risk of it never going beyond the stage of a declaration of intent is therefore high since, in keeping with the very nature of politics, the supervisory authority will try not to make any lasting commitment, or even will not be in a position to make or keep one. The key lies in discovering a means of pushing the government and/or majority in power to undertake to carry out the plan.

One possibility consists in drawing up a formal or informal contract between the university (or set of universities) and the government. Negotiations give the university an opportunity to present its problems and solutions and, for the supervisory authority, to voice its complaints and hopes. This airing of differences cannot but encourage the supervisory authority to feel responsible for a period extending beyond the budgetary year. However, this solution carries the risk of greater interference by the supervisory body.

Considering that the desired aim is to bring pressure to bear on the supervisory authority, one might wonder whether it would not be better, and above all simpler, to base the financing of universities on objective, measurable requirements, like the number of students or the student/teacher ratio. Even if these criteria apply in certain countries, they have clear shortcomings as they subordinate university funding to a limited number of criteria which do not represent the full range of an institution's activities; there is therefore a risk that the university will indulge in tactics to make the most of the criteria applied (for example, develop a policy of growth in terms of student numbers to the detriment of quality and other services). However, the use of well thought out indicators can prove relevant when they represent one part only of those financial criteria that can induce the institution to adapt to its changing environment.

3.2 Financial support of other state entities or bodies

It is in the direct interest of state entities other than the main funding body to develop one or more universities located in their area; they should therefore be prepared to make a financial contribution.

Different situations can be observed depending on the political organization of the country. It is necessary, in particular, to distinguish between centralized countries, where higher education comes within the purview of the central state, and federalist countries, where it

comes under the regional authorities. In both instances, one finds that the other level of state government does not necessarily opt out; on the contrary, mindful that influential higher education institutions are in its direct interests, it is prepared to provide supplementary financial support. Let us mention the case of France, where certain regional communities are prepared to help finance universities located in their midst, supplementing funding provided by the central state, in order to improve their quality. Conversely, in a federalist country like Switzerland, it is the central state (Confederation) and non-university cantons that help finance the eight cantonal universities, in certain instances to a decisive degree.

Countries with a national policy for higher education

Universities must show regional and local political authorities how worthwhile it is for them to have a good university in their area. The many studies that analyze the direct and indirect costs and benefits linked to hosting one or several universities in a given area point particularly to the following advantages :

- They enable young people in the region to train locally while attracting students from other regions, who may be inclined to work in enterprises in the area at the end of their studies.
- They create a nucleus of skills and knowledge which, if properly used, is an asset for the local economy and cultural life in the region.
- The teaching staff and other university employees are generally good customers, and even good taxpayers for the region.

Federalist countries

The situation is quite different. Funding from the central state is justified in two ways:

- First, educational action in the Länder, Cantons or Provinces benefits the entire country. The value of basic research can freely serve the whole population; the welcome of foreign students in a local community also comes under national policy. Universities or, to be more precise, the set of universities, must thus convince the federal government that, if it fails to have them subsidized, the academic services will fall short of the desired standard, as it is by no means in the interests of universities to take account of benefits that do not accrue to them.
- Second, countries must take account of the fact that efforts in the field of higher education are uneven; if the gap is too pronounced, there is a danger that certain regions will restrict university access for inhabitants from other regions. This justifies the creation of an equalization system either at the level of the federal state (vertical equalization) or among the regions (horizontal equalization).

3.3 Financial contribution from students (fees)

Levying fees is a far from negligible source of funding for universities, particularly as it is also advantageous in terms of resource allocation. It is generally acknowledged, however, that at least in Europe only a small proportion of university costs can presently be passed on to students, and this for at least four reasons :

- academic effort by students is of broader benefit to the entire community; it would therefore not be proper to make students pay the entire cost of the training they receive,
- part of the cost of a university springs from research activities, which share all the characteristics of a collective good (in other words, the beneficiaries of these activities cannot be identified and requested to pay directly),
- countries as a whole would avoid the cost of studies to be an obstacle to students from less affluent backgrounds,
- the usefulness of university studies cannot be measured exclusively in terms of economic profitability; it is necessary also to take account of the cultural contribution

to society.

To deal with this matter, it is necessary to ascertain whether the university is mainly funded by the state or not.

Case of universities mainly funded by the state

In terms of resource allocation, the financial advantages justify covering a small portion of the costs through direct student participation in the form of fees. However, it is difficult to lay down a percentage as it will depend on the restrictions recalled above and the historical and political context of each country and university.

It is also possible to provide for differences depending on the course of study, but they should remain minimal in order not to penalize costly fields like the hard sciences or engineering, which are not very popular among students as it is.

Empirical studies show that reasonable fees are a minimal deterrent in terms of the desire to study, simply because living costs during studies and, above all, the hidden cost rooted in the remuneration a student must forgo while studying are proportionately much greater.

However, it is necessary to avoid at least two pitfalls :

- Universities envisaging this policy must endeavor to obtain solid guarantees from the supervisory authorities so that they will not offset new income by reducing financing from the state budget.
- No effort should be spared to enable all persons capable of university studies to go on to higher education, whatever their social background. Any rise in fees thus entails an increase in financial aid, be it grants, scholarships or loans.

Universities largely independent of state financing

The situation in these universities is different as they have to cover the bulk of their costs without state assistance. This is why, in any event in Europe, these institutions tend to limit their activities to fields where demand is strong and do little or no substantial basic research. Furthermore, they pay scant attention to the question of access to university. Hence, the unit cost of training a student is, in principle, lower than in the universal, state universities; this enables them not to have to levy exorbitant fees, that necessarily act as a deterrent.

These universities can tackle the problem of financing from two angles :

- They can endeavor to increase recruitment through supply better adapted to demand in order mainly to increase income and secondarily to reduce the cost of training a student.
- They can seek to increase their endowment and obtain direct aid from enterprises, and even the state. This latter action leads us directly to the 4th source of income.

3.4 Income generation in the private sector

Universities, whether largely funded by the state or not, must involve the private sector in their activities (sponsoring). Indeed, private companies, foundations or possibly public bodies can offer universities substantial support, mainly in two ways.

- Universities can try to obtain direct aid with no strings attached (at least formally) in the form of donations or low-cost loans. They can thus seek to develop their infrastructure (buildings and equipment) or complete the teaching offered thanks, for example, to the creation of professorships financed by private companies (the teachers are chosen according to the university's own rules).
- The universities, or rather their sub-divisions, can also propose their services by offering to develop products or tools, or to conduct expert evaluations, within the

framework of applied research mandates. In this case, the universities make material and human resources available. Financial interest will thus depend on their visibility, the price at which they can sell their services and the efficiency with which they do the work. Yet one must remain realistic : research contracts do not bring in much fresh money. They make it possible, however, to complete facilities and/or finance additional researchers, thereby increasing the unit's potential. The provision of lifelong learning at the request of enterprises or organizations comes under the same heading. Furthermore, universities can rent their premises and certain facilities they own when not used.

- Finally, universities can try to develop *l'esprit de corps* of the institution, not only through keeping the links with alumni, but also through inviting them to contribute financially to the improvement of the university's image and welfare.

The quest for greater financial support from the private sector is not without drawbacks either. The risk one exposes oneself to is, in any event, outside influence. This risk is probably no greater, however, than the pressure brought by political circles on universities under state funding.

3. Conclusion

Since the beginning of the decade, the vast majority of universities has faced the harsh reality of two contradictory trends : an increase in the services expected of universities and a stagnation, or even drop, in the financial resources at their disposal. Higher education may be at a turning point. This is all the more relevant considering the key reports issued by influential bodies which recall forcefully the extreme importance of education for society².

Nevertheless, even if the first reaction is disappointment, one should never forget that all the organizations, without exception, are fighting to perform overly extensive tasks with too little means. Therefore, this time of upheaval and challenge is an opportunity worth seizing in order to strengthen the contribution universities make to our society.

In order to generate more income, whatever the source, universities must therefore show in a convincing manner that they are adapting to their changed environment in order to better fulfill their mission.

LW, 02.09.96

² European Commission, *White book on education and training : teaching and learning; towards the learning society*, Brussels 1995, and Report of the UNESCO International Commission on Education for the Twenty-first Century, preliminary synthesis, Paris, October 1995, full report due for publication mid-May 1996.