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Tertiary education in small states N°2

Finding solutions for sustainable financing of tertiary education in small states

Overview

Increased social demand for tertiary education in small states and the desire of these countries to participate in the knowledge economy have led to the need for greater investment in tertiary education. But where will the significant finance for needed investments come from?

Good decisions about financing a sustainable tertiary system depend upon the effective resolution of key policy issues concerning the shape and the nature of the tertiary system and who will pay for what. Sustainability also requires: predictable government funding; a clear position on private sector participation in education; public-private partnerships; entrepreneurial interventions; commercialization; leveraging of regional and international partnerships; and various forms of equity financing together with solutions for student support.

The future is clearly in sharing costs, diversifying income sources, creating new sources of income, building partnerships at home and abroad, and creating wealth beyond teaching and research.

United Nations Educational, Scientific and Cultural Organization

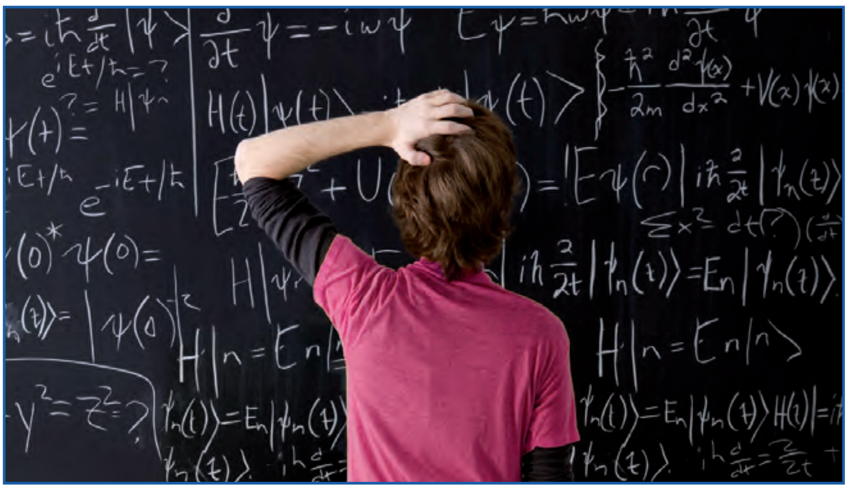
International Institute for Educational Planning

Framing the problem: The challenges of sustainable financing in small states

Increased social demand for tertiary education and the desire of small states to participate in the knowledge economy have led to the need for greater investment in tertiary education. Small states wish to bridge the development gap between themselves and larger, better resourced countries through human capital formation. But many of them still have not universalized school education and need to upgrade its quality. Within a context of multiple demands, many still face a challenge of prioritizing investment across education levels.

While the world's tertiary enrolments have grown from 98 to 159 million from 2000 to 2008, meaning a total growth of 62 per cent, some of the universities located in the small states have grown even more rapidly. This is the case for instance of the University of the West Indies and the University of the Gambia where tertiary enrolments have grown by 115 per cent and 533 per cent respectively in the period 2000-2008.

In the area of financing tertiary systems, small states face particular challenges. Greater vulnerability to fluctuations in economies that are dominated by single commodities make financial sustainability risky. Indeed, small states do not drive global economic and financial policy, nor do they determine commodity prices on the world market. They are thus more vulnerable to financial crises in the global economy. This was demonstrated again when the financial crisis of 2008-2009 hit small states particularly hard (World Bank, 2009). Small states are also more constrained in their access to both external and internal capital. This is due to limitations in the number of private sector organizations and the level of sophistication of local or regional financial markets, and also to the ability of some small states to service debt obligations.



Finding solutions to finance tertiary education can be intricate.

'The financial vulnerability of small states inevitably impacts on individual tertiary institutions.'

Tertiary education is the most costly level of education in any country. Providing a full range of learning options and opportunities can be very costly in small states where unit costs are likely to be higher because of greater difficulties to achieve economies of scale.

The financial vulnerability of small states inevitably impacts on individual tertiary institutions. Less funding from the government means that individual institutions need to find ways of reducing cost, take steps to become more efficient and effective, and find alternative sources of funding. For such institutions, the latter can be a daunting task since small states tend to be more limited in the number of private sector organizations, the number of wealthy alumni able and willing to be benefactors, and in opportunities for income in contract research.

Box 1. Some policy questions with implications for funding

- Where does tertiary education fit, in terms of national strategy for development?
- What are the policy goals for tertiary education? Can a financial incentive formula be designed to steer a mix of higher educational institutions to achieve policy goals?
- What is the role of the state in a diversified tertiary education system?
- What is the role of the state for research and what is the funding strategy?
- What is the desirable limit of state expenditure?
- How much infrastructure is the state prepared to pay for?
- How can a student financing system be developed with due consideration for equity?
- Will there be a support system for students to study abroad? What will be the mix between study abroad and local provision?
- What is the policy on e-learning and distance education and how will this be structured and managed?
- Will the private sector be permitted to invest? Under what conditions?
- What is the approach to regional and international collaboration and cooperation?

It needs to be acknowledged that small states are not simply smaller versions of large states and cannot reasonably be expected to match proportionately large states in resources and resource generation.

Solutions to the challenge of sustainable funding for tertiary education in small states need therefore to allow small states to craft a strategy for a sustainable future for themselves in a knowledge world through institutions that can also develop the wherewithal to build sustainable futures on their own.

Linking funding and financing policy to choices

Good decisions about financing a sustainable tertiary system depend upon the effective resolution of key policy issues that will determine the nature and the shape of the tertiary system and who will pay for what.

Small states need to be very clear about their objectives for development and integration with the global knowledge economy. They should derive this clarity on policy and strategy from a realistic appreciation of where a country or region stands in relation to certain key variables and in relation to comparator countries. Against this background, strategic choices and costs associated with them become paramount. The questions in *Box 1* are suggested for taking a rational and proactive approach towards policy-making that will ultimately determine the configuration of specific financial challenges to be addressed.

A sustainable funding strategy for small states

There are three major financing issues that all small states will need to address. The first is the sustainable financing of expanding publicly funded tertiary education. The second is the need for better mechanisms for student support in a context of growing demand and a socially more diversified student body. And the third issue is the need to expand and upgrade infrastructure to support a more diversified set of offerings with greater emphasis on costly areas, such as in science and technology.

How does one begin to apply a funding strategy that is sustainable to support development, expansion and responsiveness in small states given the many issues which need to be considered, including sustainable high quality?

Predictability for state-funded institutions

First of all, in the case of the state funded sector, it is necessary to ensure predictability of financial flows for institutions. An agreement needs to be reached on a funding cycle, let's say on a three-year basis, which would provide a framework for planning, implementation and accountability, both for government and individual institutions. This would probably involve governments determining the percentage of GDP to be allocated for education as a whole, and then determining the split between preschool, primary, secondary, vocational, and tertiary, and then among institutions in the state system according to their particular mandates and certain performance criteria identified by the state.

This would also help to rationalize the focus of each institution and help each institution to clarify its own objectives while giving them the freedom to determine how to proceed with their mandate by developing strategies for the

Box 2. Income-generation activities at the University of the West Indies

In 2004 the Principal of the UWI's St. Augustine Campus in Trinidad created the Evening University, to cater for working adults with a minimum of new overhead costs but with effective support from participating faculties. This initiative has generated a sizeable income annually.

In 2005, the same Principal entered into an agreement with RBTT Bank in Trinidad & Tobago to purchase Roytec, a tertiary institution which had built up a relationship with the University of New Brunswick in Canada for the granting of degrees and diplomas. Roytec, later renamed the UWI Institute of Technology and Applied Business Studies, continues a constructive relationship with the University of New Brunswick and has made a strong annual operating surplus on an ongoing basis.

In 2004, the Principal UWI St. Augustine created a Business Development Office to support fund-raising to seek knowledge-intensive business opportunities and opportunities for research grant funding.

The Institute of Business (now Arthur Lok Jack Graduate School of Business) was opened as an entrepreneurial initiative of UWI and the local private sector in Trinidad in 1990. It has been operating as a profit-making institution since 1994. Today it has achieved self-sufficiency on the basis of land grant from the government, endowments from the private sector, loans, market rate fees and training and consulting initiatives.

The Principal of the UWI's Cave Hill Campus in Barbados took the initiative in 2006 to transform a clinical medical facility in Barbados into a full medical school which would be self-financing. The school was financed by loans from local banks to be repaid from tuition fees and other sources.

The Principal of UWI's Mona campus, Jamaica, also invested in a state-of-the art basic medical sciences facility to support expanded (foreign) intake into the medical school and the creation of a dental school. The basic medical science facility was expected to recover the investment and generate a surplus thereafter.

On all campuses, dormitories, bookstores, guesthouses and other commercial enterprises are run on a cost-recovery basis and generate a small surplus.

Source: Tewarie (forthcoming).

'An important issue is how to involve the private sector as part of the solution to the sustainable funding dilemma.'

non-government funded portion of their budget. This could also include a framework for reducing subventions over time up to an agreed limit. Such an approach, however, would mean greater responsibility on the part of individual institutions for self-financing.

It is clear that the state must continue to support higher education in a predictable way notwithstanding these very real difficulties and challenges of small states. Because failure of the state to support tertiary education could translate disproportionately into high expenditure in the future on penitentiaries and social welfare programmes as well as low scores on the Human Development Index.

Income generation by tertiary education institutions

Individual institutions would have to increase their non-government sources of income in a systematic manner to sustain the same or higher levels of expenditure, or find ways of reducing cost and/or increasing efficiency in the context of definitive arrangements reached with government.

Individual institutions can then proceed in at least three ways. They may: (1) develop a range of mechanisms and/or pathways including ventures, of one kind or another, related to their core business of education delivery, research and service; (2) harness commercial opportunities in activities associated with the university to generate income such as housing, restaurant facilities, bookstores, etc.; and (3) create structures and infrastructure to support fund-raising initiatives to engage possible donors and to attract research funding. These may include endowment funds, business development offices, technology transfer offices, event management units with specialized functions and targets.

Accessing private capital

An important issue is how to involve the private sector as part of the solution to the sustainable funding dilemma. Examples drawn from the experience of larger and more developed countries may well be transferable to small states. Bonds, securities to access private capital, investments by private equity firms in private institutions in anticipation of future profits, loans and philanthropy are some of the options (Hahn, 2007). There is no reason why bonds or security instruments to raise private capital cannot work in a small country or in a regional context. The challenge would be to find a workable format for repayment of the debt, but the value would be in the financial freedom and flexibility it would provide and the predictable commitments to debt servicing. A complication would arise if loans were negotiated in hard currency and severe fluctuations occurred between the currency in which the instruments were negotiated and the local currency but this can be offset by tying loan repayment to hard currency revenue streams.

The extent to which private equity investment could be accommodated would depend on the policy position adopted by a particular country or institution, but equity participation in offshore schools has shown that such possibilities are workable in a small state depending on the target market. Offshore schools have emerged as successful investments in Caribbean and Indian Ocean islands such as St. Kitts, Dominica and Seychelles, and variants exist in Oman. Moreover, permutations of equity participation, philanthropy and loans can be explored. It needs to be acknowledged that philanthropy in small developing states can be a challenge and that therefore the culture of philanthropy has to be nurtured over the long term and, in any case, the pool of potential philanthropists will never be that large and the pool of available funds could never match that of larger, wealthy countries.

Financing tuition and student support sustainably

In many small states, tuition at the tertiary level is free (which means that the state pays) or is subsidized (which means that the state pays a part). Scholarships and bursaries provided either by the state, the educational institution, or from private sources are usually limited in number. Expansion of tertiary access means that financial support will have to be made available to help a growing number of students pay for their tuition. Inevitably, countries will have to opt for an education loan system or taxation or some combination of the two.

The significance of a loan or taxation system which targets the consumer of education is that it shifts the burden of payment by the student from the point of consumption to after graduation when the graduate is able to earn. But loans will only become attractive to students if they are tied to earnings (that is, income-contingent). And taxes will only become acceptable if incomes are high enough to make taxes bearable. This means that an economy would have to have the buoyancy, diversity, and absorptive capacity to provide attractive incomes. An income contingent loan system in a small economy is likely to support access as well as equity. A graduate tax system will target graduates only when they develop earning capacity, and in that sense it is an equitable tax if only in the context of working citizens who are graduates of tertiary level institutions.

Making tuition fees payable by the student takes cost sharing directly to the primary beneficiary while acknowledging that education is also a public good and must be supported by the state and private sector interests. Indeed, they are also beneficiaries of every throughput of graduates annually and of a national pool of educated graduates generally. Effective loan repayment systems and tax regimes can ensure that at least some of the financing of tuition fees for continuing waves of students can be met from an identifiable, even if not entirely predictable, source. It is important for increased throughput from the tertiary sector to be accompanied by economic

Box 3. International equity participation in Oman in partnership with government

The pressure on tertiary education arising from completion of secondary education continued to grow rapidly in the 1990s in Oman. Since the mid-1990s, the Omani government has actively encouraged the participation of the private sector. The Ministry of Higher Education set regulations for the establishment and monitoring of performance of private institutions. It decided that private institutions must be affiliated to recognized and accredited foreign universities.

The Omani government is directly involved in the ownership of two private tertiary education institutions. The International Maritime College of Oman (IMCO) is 70 per cent owned by the government and 30 per cent by the Shipping and Transport College of the Netherlands. The Oman Tourism College commenced with 100 per cent ownership by the Government of Oman through the Ministry of Manpower, with a plan to privatize as government ownership is gradually phased out.

Source: Al Shmeli (forthcoming).

Box 4. Tertiary education: Who benefits? Should this inform cost-sharing strategies?

Students – personal development

Graduates – learning, competence, skills, higher income, and improved labour market prospects

Families and households – higher income earner, ideas leader, more enlightened households

Private sector – competent, skilled worker who can continue to learn

Public sector – competent, skilled worker who can continue to learn

Community – participant, contributor, leader, organizer

Nation – increased human capital with positive effect on economy, democracy, and health

A student doing lab work in a chemistry class

growth and diversification to absorb that throughput or else migration may become an issue, loan repayments can become a problem, and the graduate tax be undermined.

Education is a public good that benefits private individuals and multiple interests in a society. Thus the principle of cost sharing is not an unreasonable proposition. Individual students benefit as graduates; families benefit from having educated members in the household. The private sector benefits in the form of educated and competent employees as does the public sector, and the nation benefits from human capital appreciation not only in its economic impact but also in terms of democracy. This point of view might legitimize cost sharing through fees, contributions and taxation. A challenging issue, however, would be to determine the amount, the proportion of respective shares, and to develop a framework supportive of a mutually acceptable sharing arrangement. This particular challenge needs to be addressed by each individual state in its own way.

And finally, community participation in education is desirable as well. When community interests participate in education they bring investment, values and commitment to a cause, which serves to strengthen individual and community citizenship responsibility and increases the number of entities actively engaged in making direct contributions to national goals and objectives. Religious organizations, community-based organizations, and NGO's should be encouraged and facilitated to participate and invest in tertiary education provision to share the burden of cost but also to spread the mantle of responsibility, to encourage diversity, to strengthen commitment to national development objectives and to foster inclusion.

An individual institution could then work through its strategy based on agreed government subventions, enrolment targets linked to tuition fees and funding outside of these two categories for which it could select from a menu of options (see Box 5) including grants, endowments and borrowings.

Box 5. Menu of possible options in tertiary financing

- Government
- Tuition fees
- Community investment
- Donations, endowments, philanthropy
- Commercial operations
- Entrepreneurial ventures
- Private sector investment
- Fundraising infrastructure for events/projects
- Bonds, security instruments, and loans
- Student loan system
- Graduate tax

The way forward

All small states and regions of small states need to craft systems, building on what they have which can be rationalized on the basis of financial sustainability. Thinking in terms of systems will allow smaller countries and their leadership to conclude that, while it might be impossible to build a world-class university in every small country, it may be feasible to build a national tertiary system that is appropriate for those who are served by the system – in terms of relevance, responsiveness, quality and value – no matter how small the country.

Moreover, it may well be possible in regional contexts to strive for a world-class regional system enhanced by strong national systems. Development of strong, effective, competitive systems in this manner can only be achieved if synergies are created to offset the challenges of scale. This requires a genuinely favorable disposition toward collaboration which would then make effective coordination possible.

Realistic budgetary planning must accompany policy formulation and strategic intent and this must inform practice on the ground as well as sources of income strategies to support the general thrust. System rationalization, harmonization, integration, coordination and management are required to ensure minimal duplication and waste as well as coherence. Thereafter, a realistic approach to funding the higher educational enterprise can be taken by the country or region concerned. In a fundamental sense, the position being articulated in this document represents a plea for system coherence and rationality. A systemic approach would require at least three elements: i) a strong quality assurance framework that would facilitate the portability of credits; ii) an effective accreditation mechanism; and iii) strong governance arrangements for the system as a whole through a Tertiary Education Council or some equivalent.

There is abundant evidence that higher education makes a decisive difference in the development and transformation of economies, and hence sustainable financing of tertiary systems of education is a challenge that must be met. Sustainability requires predictable government funding, a clear position on private sector participation in the education sector, public-private partnerships, entrepreneurial interventions, commercialization in higher educational institutions, and leveraging regional and international partnerships. The future is clearly in sharing costs, diversifying income sources, creating new sources of income, building partnerships at home and abroad, and creating wealth beyond teaching and research.

It needs to be acknowledged that there is a necessity for governments to continue to support tertiary education in a small state; but government cannot be expected to be the sole source of financing for tertiary education. Sustainable development needs demand creative solutions to the dilemma of both additional financing as well as alternative sources of financing to supplement government funding.

> ‘Sustainable financing of tertiary systems of education is a challenge that must be met.’

The overriding dilemma is the complex array of forces that need to make wealth generation and development happen in any national context. Tertiary education alone will not make development happen; but development in the knowledge era cannot happen without tertiary education. A sustainable tertiary education system is a necessity in a small state for that state and its citizens to participate in and benefit from the global knowledge economy. Yet one needs a thriving economy to generate the wealth necessary to fund a tertiary system sustainably. This will be a continuing dilemma which small states will have to resolve with creativity, enterprise, and innovative solutions.

Meeting with heads of administrative units at UWI

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