Hochschul
Rektoren
Konferenz

HRK

australiacentreberlin

The Future of Higher Education Financing in Germany

German – Australian Conference on Higher Education Financing
Berlin 24 – 25 October 2003

Professor Rainer Künzel
President
University of Osnabrück

Dear Colleagues, Ladies and Gentlemen,
for me it is the third meeting with university leaders from Australia. Facing a knowledgeable group like this, it is a pleasure, but also a challenge for me to talk about the future of higher education financing in Germany.

Even if I wished to do so, I could not attempt to summarize the discussion of the past two days or to propose solutions to some of the issues discussed so far, because, unfortunately, I was not able to attend the conference yesterday. But a number of critical points on the way towards a sound financial basis of German institutions of higher education seem to be quite clear.

Transformation to a knowledge-based society

The German higher education system has gone through a paradigm shift from a rather elitist system, providing higher education to a select few, to a system of mass education**.** This development reflects drastic changes in society: Scientific findings and methodology have become the basis of all decisions to an extent previously unknown. This is similarly true for the public as for the private sector. Even in the political sphere, most decisions are based on scientific methodology and reasoning. Universities are the only institutions which are devised to enhance and also convey the indispensable scientific knowledge for this modern society.

Higher education as public responsibility

Higher education clearly is a public responsibility. In today's knowledge- based society a well-qualified and highly specialized workforce is needed. University graduates generate societal benefits that justify the investment of public funds in higher education. Economic growth and practically all other advancements in society rest on the growth of knowledge and on the qualification of the work force.

In order to provide quality in teaching and research, universities must be provided with a solid funding basis that is not contingent upon the political struggle about the distribution of taxpayers' money between competing ends.

This implies contracts between the institutions and the state spanning a period of several years in order to allow for a mid- to long-term development strategy.

At the 2000 Lisbon European Council the importance of public investment in higher education was emphasized. The European Union formulated as a goal for the next decade to become the most competitive and dynamic knowledge-based economy in the world. In the Summit Meeting held in Barcelona in March 2002, it was stipulated that in order to achieve this objective the European Union would have to invest 3% of its GNP in research and development by 2010.

Nowadays, the economic welfare of a nation and its international competitiveness are largely determined by the quality of its people's education. This is especially true for a country with practically no exploitable natural resources like Germany.

Therefore, the current debate on further diminishing the role of the Federal Government in funding higher education can only be looked upon with great concern. The shared responsibility of the Federal government and the *Länder* governments for funding universities and other research institutions ensures comparable educational opportunities and internationally competitive universities throughout the sixteen states of the Federal Republic.

Autonomous financial management as a prerequisite for success

As was said yesterday, many reforms paving the way toward more flexible and competitive higher education budgeting have already been implemented. Single block operating grants, for instance, are certainly a step in the right direction. But fully self-determined and self-responsible institutions of higher education ought to be able to act like private enterprises. They cannot be efficiently operated by external bureaucratic regulations.

The political, strategic and operational responsibility for the institutional development has to lie with the university leadership. State governments, preferably independent buffer organizations like f.e. the planning and budgeting committee in Israel, should confine their role to the formulation of long-term targets for the development of the state wide system of higher education on the basis of careful strategic planning.

For a successful, output-oriented financial management, institutions of higher education must be able

(1) to build up financial reserves without having to fear that savings might be confiscated by the state authorities;

(2) to own property and manage their buildings and real estate with the necessary financial funds being part of the university budget;

(3) to employ their academic and non-academic staff at terms compatible with the operational requirements of teaching and research;

(4) to recruit their academic and non-academic staff without any outside interference;

(5) to select their students, and

(6) to offer educational programs on the basis of contractual funding regulations with the state.

As we heard before, a new model of university governance which meets some of these demands, has been implemented in the State of Lower Saxony, the home state of the university I represent. Some of the state institutions of higher education have changed their legal status to that of a foundation under public law.

My university has not yet joined the group of pilot universities, because until fall of last year the majority of the members of our Academic Senate feared that they would lose too much power to the external Board of Governors. Many of the important innovations of the new state law for higher education apply to every university, however, so that we are not in a hurry to change our legal status.

Despite a general pledge for more competition between higher education institutions, most state governments have, until now, shied away from a real task- and performance- (or output) -based funding formula for the universities. Naturally, a more competitive allocation of financial funds will increase the budget of some institutions and decrease the budget of others. Universities have to focus on their strengths and accept possible cutbacks in weaker areas. It is the individual states' and the federal government's task to provide a framework that ensures a balance in educational opportunities for the system as a whole.

Diversification of financial funds

In view of the across-the-board cuts of public funds we have witnessed in the recent past universities must diversify their sources of income. It is apparent that state funding will be decreasing rather than increasing in the years to come while the demand for highly qualified university graduates will grow continuously. The ongoing economic recession and new societal challenges, however, are bound to force even the most well-meaning governments to reduce expenditure and investment in higher education.

This leads to the conclusion that universities need access to revenue independent of the state. Of course, universities already supplement their allocated budgets with third-party funds for research, mainly through national or EU research funding programs, and industry.

Alternative ways of income generation for institutions of higher education must be further explored. This includes the licensing of patents, revenue through services and continuing education, fundraising and sponsoring contracts, networking with alumni, and - last but not least - engaging in business operations akin to the universities' capabilities in R & D.

Another possible source of revenue that has been in the focus of our attention during the conference are tuition fees. Before I take up the question of fees, however, I would like to allude to the specific responsibilities connected with a changed funding scheme.

Responsibilities of the universities

For our institutions of higher education a diversification of sources of income does not only lead to new opportunities, but also to new responsibilities. Increased university autonomy in financial matters in combination with more decentralized financial management does not mean that universities are entirely free to spend their lump-sum budgets without being held accountable for their decisions. Increased autonomy goes hand in hand with increased accountability. Transparency and accountability towards the general public must be part of a comprehensive internal and external system of quality assurance. The university's profile and the institution's mission in teaching and research should guide the institution's financial decisions so that the allocation of funds is optimized.

Responsibilities of the state governments

Reforms in higher education management do not only pose challenges to the universities, but also to the governmental authorities in charge of higher education. Just as the universities are restructuring to become fit for the 21st century, the higher education ministries have to modernize their administrative system. As long as the institutions of higher education are forced to adhere to often outdated and much too detailed bureaucratic requirements of state administration, they will not be able to function in an efficient and effective way.

Tuition fees as a source of revenue

As discussed yesterday, even though the German institutions of higher education are dramatically under-financed, they are so far not allowed to earn revenue in one of their major fields of activity, i.e. in teaching. We have heard many arguments in favor of as well as against the introduction of tuition fees. The danger of blocking off potential students from socially disadvantaged families has been one of the main arguments against tuition fees. Another one has stressed the point of inter-generation equity.

In fact, however, the alleged social injustice holds true for a higher education system in which the tax payer has to cover the cost for an individual's university education in full. Financial studies show that, on average, university graduates manage to realize a substantial income advantage over non-academic employees during their working life. In view of this advantage, it seems justified to ask the individual graduate to share part of the financial burden for his or her education.

Furthermore, a 2001 study by the Organization for Economic Co-operation and Development (OECD) has shown that the individual's rate of return on investment with regard to post-secondary education is particularly low in Germany. This can be attributed to the long average duration of study in combination with relatively high costs of living. Here, tuition fees would certainly have a positive steering effect, provided the revenue from fees were at the free disposal of the higher education institution.

With regard to the social balance that needs to be preserved, and in view of its greater demand-orientation compared to Australia's HECS I am in favor of the New Zealand variant of student contribution to higher education. In addition I would like to suggest an education savings scheme analogous to the German real properties savings scheme that was based on the former § 7 b Income Tax Law.

I must admit that Australia's HECS might be easier to combine with the German supply-oriented steering mechanism in higher education. Contracts between the individual institutions and the ministry about the kind and number of study places to be offered would imply a lump sum funding obligation on the part of the state which would not depend on the kind and number of study opportunities actually utilized. But as in practically all centrally planned systems reactions on a mismatch between supply and demand would be slow or even non-existent. Also, since the cost structure is not the same in all institutions, prices fixed by the state do not reflect supply conditions, either.

The New Zealand solution to the problem - although it is not a pure market solution - simulates market forces much better, because enrolled students, not study places, are subsidized, and the universities can fix tuition fees according to costs and market position. The state is still able to influence the strategic orientation of the universities indirectly by varying the amount of subsidy paid per student or graduate in a given educational program. It is, of course, important, that the state subsidies are not combined with prescriptions as to what the money ought to be spent for.

It can be shown by standard economic reasoning, that such a flexible system will lead to a better cost-benefit relation than a system relying on non-price rationing of study opportunities like the one we have been living in to date.

In New Zealand the conditions for repaying the loans seem to be skillfully devised as well. Instead of a limit to the taxable income beyond which repayment is due at progressive rates from 3 to 6 per cent, as in Australia, the

New Zealand scheme allows for a certain sum to be deducted from taxable income before repayment at a fixed percentage rate begins. The New Zealand regulations thus avoid discontinuous variations of repayments with growing taxable income. Less convincing, however, is the addition of a nominal interest rate to the rate of inflation when the current value of loans is determined, since nominal interest rates are themselves influenced by - among other factors - the rate of inflation. In addition to this argument it would only be fair to block off the influence of monetary policy on the cost of long-term loans for education. Therefore, if an interest rate must be calculated at all, it should be low and constant over time. The same argument pertains to the conditions for an additional subsistence loan which in New Zealand has the advantage of not depending on need - and thus on the students' parents' financial situation - and of not increasing the yearly volume of repayment but rather the duration of repayment obligations.

The often heard argument that tuition fees on the basis of loans will shift too much of a financial burden on future generations and thus violate the principle of inter-generation equity cannot be denied relevance. Therefore, long-term financial provisions for the education of children should also be subsidized. A suitable savings scheme could be that of the former German real properties savings scheme that allowed to choose between tax benefits or a state subsidy when the savings were used to buy real estate or build a home. Such a savings scheme would motivate parents to invest in the education of their children and it would - through the state subsidy - shift some of the burden on the shoulders of those citizens who have no children of their own to care for while they, too, will depend on the qualification and productivity of future generations.

In closing I would like to pass on to you an idea of a colleague of mine, Ludwig Schätzl, the president of the University of Hannover, who has suggested that universities should divide their income from tuition fees into three parts

- one to support the needy students
- one to improve the present conditions of teaching and learning and
- the third one to build up a university foundation, an endowment, which will help to improve and modernize the universities' offerings of educational opportunities and - in the long run - help to ease the burden on future generations of students.