
Economic Perspective 4

FINANCING HIGHER EDUCATION : GRANTS OR LOANS?

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In the United Kingdom, opinion on whether the provision of grants to university students should be replaced by a loans systems tends to be divided on orthodox political lines: the "right" supports loans and the "left" supports grants. There is no intrinsic reason why this should be so, and alignments in some other countries are on a quite different basis.

There is no reason why the "left" should support grants as a matter of principle, because the sons and daughters of the relatively well-to-do are much more heavily represented among the beneficiaries than sons and daughters from low-income families. It is probably the case, as we shall explain, that **some** types of loan programme would pose severe problems for students from low-income families, but it is possible to design a loan programme which would increase opportunities to students from low-income families.

The best available evidence for Scotland indicates that middle-class families provide six times as many university students in relation to the number of their children in the relevant age groups as do working class families. The bias is less marked in other forms of higher education but it is still substantial. It is also the case, although recent figures are not as readily available, that among families identified as being working class, the more highly skilled and the relatively affluent provide a much larger proportion of students in higher education than do unskilled and low income families. It is also the case that, despite progressive income tax, low income families provide a not insubstantial amount of government revenue through the form of indirect taxes. A grant system means that, in aggregate, low income

families are helping to provide a subsidy to families wealthier than themselves.

Furthermore, university and other forms of higher education enable their beneficiaries to earn higher incomes, on average, than those who do not continue their education. There is disagreement among experts about the appropriate way in which to measure the effect, and consequent disagreement about its magnitude, but few experts dispute that there is **some** positive effect. It is, moreover, clearly evident that many university students expect to earn higher salaries as a result of their studies than they would otherwise have done; indeed, it is quite evident that this is the principal reason why many of them are there.

There is, to say the least of it, some doubt about the equity of an arrangement by which people whose sons and daughters do not attend university should subsidise students who will, as a consequence of the subsidy, earn more money than will their own children.

It would, however, be quite wrong to suppose that opposition to the replacement of grants by some form of loan scheme is necessarily based either on misunderstanding or on a desire to maintain the privileges of a relatively affluent minority. Relatively few students are drawn at present from low income families, but **some** forms of loan scheme would probably reduce that already small proportion quite substantially.

Before discussing the issues which give rise to major differentiation among loan schemes, it might be useful to mention a few points which have a bearing on the practicability of different ways of financing higher education.

It has been pointed out by members of the Government that students in many other countries are expected to provide, with or without a loan scheme, a much higher proportion of their living costs than is the case in the United Kingdom. This is certainly true of the United States. Some caution should, however, be exercised in drawing what appears to be the obvious inference. Institutions and custom have a significant effect upon opportunities.

It has long been common practise in American universities to provide a wide range of jobs, such as working in the student canteens, which can be taken by students on a part-time basis. There may be merit in adopting a similar approach here, but, in present circumstances, the opportunities for students taking a part-time job which does not directly interfere with their studies are much more limited. It is not uncommon for American parents to finance their children's education through a second mortgage: an option not available to large numbers of Scots.

Account should also be taken of the American method of undergraduate assessment. Students take a series of self contained courses, for which credit is awarded according to performance. It is a simple matter for a student to take a term or a year (or more) away from the university, and to move from one university to another, taking his (or her) accumulated credits with him (or her). It is not impossible for a British student to take a year out, but he will, typically, be obliged on return to take an "all or nothing" examination which will be based on a programme which may have changed during the student's absence. There is virtually no opportunity to take a few months out unless the student is able and willing to cover the course work in his spare time. There have, indeed, been a number of occasions in which outstanding athletes or rugby players have been obliged to chose between completing their courses and competing in a world class event.

Another important consideration is that in countries where it has long been the practise for students to pay a substantial part of the costs of education, professional salaries have reflected that cost. One of the reasons why American medical earnings are so much higher than those of their British counterparts is because of the high costs of medical education. It might be better, in the long run, for graduate salaries to reflect the cost of training, but there would be considerable problems during the transitional period when customary earnings were being adjusted to take account of the new circumstances.

This brings us to consideration of some of the issues involved in determining the type of loan scheme to be established.

The first concerns the proportion of total costs which the student will be expected to cover. Many schemes (such as that in Sweden) make no charge for tuition, and provide some combination of grant and loan to meet living expenses. This means that most of the full cost of education is met by the community rather than the individual, and this is unlikely to satisfy the full blooded proponents of the view that individuals should be responsible for the costs of their own education. If, however, students were to pay the full cost, the price to them would be high indeed. Full cost tuition at a medical faculty together with living expenses could run to £5,000 a year for six years. Tuition in an arts faculty together with living expenses might be £3,500 a year, which for a Scottish four year degree would run to £14,000.

The second issue concerns who should provide the loan, and on what terms. The "objective" credit worthiness of candidates from low income families is bound to be much weaker than that of candidates from wealthy families. A commercial creditor will be interested in collateral and in the possibility that other members of the family will be able and willing to meet the debt if the student is unable to do so. If, on the other hand, the community acts as guarantor for any candidate offered a place at university there is the possibility of substantial loss due to failure to meet the terms.

The third issue concerns the terms of the loan. What is the rate of interest and what is the payback period? In Sweden the interest rate is heavily subsidised and the normal payback period is fifteen to twenty years, with the first payment required two years after graduation; in the United States there is a wide variety of schemes, some of which are at the market rate of interest, with payback periods of eight to ten years. If full cost tuition were charged to British medical students, with a market rate of interest of 14% and requirement that interest charges be applicable from the first year of the loan (ie a "proper" commercial agreement), but not actually paid until after graduation, a student could finish his six year course with a debt of over £40,000. If, as seems likely, full cost tuition would not be charged and a subsidised interest rate would be offered, the debt could be very much lower, but at the cost of "fudging" on principle.

What will happen if the student cannot meet one or more of the payments? In Sweden, payments are postponed if the graduate's income falls below a certain amount. If there is any debt outstanding when the graduate reaches the age of 65 it is met by the community. It appears to be the case that there is little default on these terms. In the United States, where vigorous action has recently been taken to recover debts, the default rate has been about eight percent and is expected by some authorities to rise to about fifteen percent in the near future.

There is, in short, a tremendous range of options among possible loan schemes. There is also considerable diversity of opinion about the purpose of such schemes, and experience in the United States indicates that there is often diversity of opinion, and consequent confusion of purpose, about what is expected of a particular arrangement.

Insofar as all loan schemes will eventually provide **some** payback, it is possible with the same expenditure of public money to provide assistance to a larger number of students than is possible with a grant scheme. No significant benefit could, however, be expected for several years after the scheme had been put into operation.

On the other hand, a loan scheme could be viewed as a means of reducing the number of students, and this would very probably mean a more than proportional reduction in the number of students from low income families.

Opponents of a loan scheme are unwise to fight their battle on grounds of principle. They would be better to hold their fire until they see the details of the loan scheme. They might find the scheme an acceptable one; if not, they would be able to fight to better purpose.