

Challenges of Financial Austerity: Imperatives and Limitations of Revenue Diversification in Higher Education¹

BRUCE JOHNSTONE

State University of New York at Buffalo

Higher education and financial austerity

Higher education has never been more important than it is today at the start of the twenty-first century. It is central to an increasingly technological and knowledge-driven economy (Task Force on Higher Education and Society, 2000). It is a major engine of individual social and economic mobility, supporting the belief that one can rise above the socio-economic station into which one was born. It is demanded by the increasing complexity of governance, and the political and civic conviction that social problems should be analysed and solved – not just in traditional ways, but with new solutions emanating from increasing knowledge and training. And, at least in high-income countries, part of the increasing private demand reflects higher education's becoming another 'superior' consumer good.

In spite of – and to some degree because of – this increasing demand, higher education seems almost everywhere besieged with problems of financial austerity: there is an uneven but nonetheless unrelenting worsening of financial conditions of most universities and other higher education institutions (HEIs), particularly to the extent that they are dependent on governmental, or tax-generated, revenue. In response, a standard nostrum of higher education economists, consultants and policy advisers (and one that is abundantly familiar in the UK) is the recommendation that universities and HEIs should reduce their financial dependence on governments or taxpayers, diversify sources of revenue and increase 'cost sharing'. The prescription is easy to rationalize, and is theoretically (and even practically) virtually unassailable. However, there are also significant limitations in a revenue diversification policy, especially in the less industrialized world where the need for such a policy may be most compelling. These limitations go far beyond the ideological distaste that many have for the neo-liberal economic medicines of

cost sharing, downsizing and privatization, and extend to certain technical and strategic dilemmas that confound even the staunchest believer in tuition fees, privatization and student lending. This article discusses some of these technical difficulties, especially problems of making cost sharing and student lending work in developing countries and so-called transitional economies.² This discussion may also serve to lend some perspective to the continuing debate in the UK, especially at a time when changes are being contemplated for the UK as a whole (arising from the current review of student finance, to be published later in 2002) and in its constituent parts of Scotland and Wales.

Financial austerity in higher education is a function of costs outrunning available revenue – counting as costs both per-student, or unit, costs and total costs driven by enrolment and degree expansion, and including as revenue both public, or tax-generated, revenue and tuition and other fees from parents and/or students. Per-student, or unit, costs in higher education tend to be high throughout the world because of the high input of relatively costly labour, costly equipment (especially scientific equipment, computing and library materials) and the expenses of student living – which are not, strictly speaking, a cost of higher education, but are expenses that must be borne nonetheless and that may be particularly significant in situations where commuting to a university while residing with parents is either impractical or impossible.

As significant and troublesome as these high costs may be, the real harbinger of austerity is the rate of increase over time of these costs. Neither economies of scale nor the infusions of capital that traditionally bring down unit costs in the larger, goods-producing economy seem to dampen cost increases in higher education. Like other labour-intensive industries, especially those where the application of technology tends to increase the quality of the product or the comfort and convenience of the producers instead of lowering the cost (and presumably the price) of the product, higher education, over time and in the absence of measures to force down these ‘natural’ increases, tends to get more expensive relative to the average increase in the cost of goods and services generally. One consequence is that both costs and prices (that is, tuition fees) of higher education tend generally to outpace the rate of inflation. This is the well-known ‘cost disease’ (a tendency to rising relative costs) in labour-intensive, largely productivity-immune sectors of the economy such as health care, education, most services and the arts (see Baumol and Bowen, 1966; Bowen, 1968; Johnstone, 2001).

In the case of public higher education, the effect of these high and naturally rising per-student costs are greatly magnified by pressures to expand enrolment. Greater percentages of the population of most countries are demanding

more higher education. Thus, demand for higher education is rising rapidly especially in countries characterized by rapidly growing populations *and* low current levels of participation – conditions describing much of the developing, or less industrialized, world.

Together, high and rapidly increasing unit costs and rapidly rising enrolment pressures place enormous strains on whatever part of total higher education expenditure is being borne by the government (or, as most economists would prefer to say, that is being borne by taxpayers, including within the concept of ‘taxpayer’ the citizen whose purchasing power is not directly taxed, as such, but is indirectly taxed through taxes on businesses that are simply passed on to consumers, or even more indirectly confiscated by the government through the inflation brought about by the printing of money to finance governmental obligations). Simply put, the ‘natural trajectory’ of those higher education costs traditionally borne by governments, or taxpayers, would take increasing proportions both of gross domestic product (GDP) and of the public budget. Underlying the case for cost sharing and revenue diversification is the assumption that substantially increased public revenues for higher education are becoming less and less likely, for several reasons.

One reason is the limitation in public revenue itself, beginning with limitations in tax capacity. Tax capacity is partly a function of the overall state of the economy. In Russia, and many of the new republics carved from the former Soviet Union, as well as in much of Africa for example, GDP has been static or declining, and prospects for vigorous economic growth remain dim. But even more serious than static or declining economies generally has been the declining ability of more and more governments to collect taxes at all. Taxes on income and sales are technically difficult to collect and too easily avoidable, depending on the government’s ability to monitor income and sales cost effectively, as well as on a developed culture of tax compliance – neither of which are characteristics of most middle- and low-income countries.

Globalization – the heightened international mobility of capital, information and productive capacity – is also taking its toll on governments’ ability to tax. Substantial increases in taxes on corporations are increasingly problematic because of this greater mobility of capital and production facilities and the resulting inclinations of multinational corporations to move to lower tax jurisdictions if they perceive their tax burdens to be too high. What used to be an easy way to ‘tax’ – that is, printing money and effectively confiscating the purchasing power of the citizenry through the resulting inflation – is also becoming more difficult as countries are losing sovereignty over monetary policies (or even, as in Europe, over their actual currencies) and are otherwise

constrained by a growing dependence on world capital markets. Finally, in the case of the formerly centrally planned socialist economies, governments can no longer rely so heavily on the value added, or turnover, taxes that used to enable the state to extract purchasing power at each stage of the governmentally owned production process. The consequence of all these factors is that most countries, and especially those with less industrialized and/or transitional economies, are having enormous technical difficulties – quite apart from any political resistance to taxation – in diverting purchasing power to finance public expenditure.

A final limiting factor in the likelihood of higher education's getting a larger slice either of overall GDP or of the government's share thereof is the diminished relative priority of higher education among the other major claimants on these increasingly scarce public revenues. This relatively low (or at best 'middle') position in the queue of claimants on available public resources, in spite of the rising importance of higher education mentioned above, is due in part to the formidable priorities of other needs: primary and secondary education, public health, public infrastructure, housing and care for impoverished elderly people, children and other dispossessed persons. This diminished priority for higher education may also be due (somewhat ironically) to the demonstrated ability of universities and other HEIs to help themselves. Most competing claimants simply do not have higher education's ability to raise tuition fees or to generate revenue from the sale of staff time and expertise or the lease of university assets. This ability is not lost on politicians straining to meet more public needs than available public revenues can support. So, while it may seem like the proverbial 'punishment for good deeds', higher education's seeming ability somehow to withstand the loss of public revenues makes it all the more likely that these losses will continue.

In summary, higher education in most countries, in the absence of policies to alter the natural trajectories of costs or public revenues, will almost certainly continue to experience worsening austerity. Significantly, the condition of austerity is both dynamic and relative, affecting rich and poor countries alike. This is because austerity (or adequacy) is in part relative to the level of revenue in the last allocation. Most expenditures in higher education are recurrent – that is, must continue over time. Generous support in one year, particularly for obligations such as wages and salaries, utilities, consumables, or student support, can become inadequate almost instantly if not continued in the next expenditure year. This is why many of the universities in the UK and elsewhere in the OECD countries can experience genuine financial austerity even at quite substantial levels of public expenditure for higher education (relative to the rest of the world), and why the president of one of America's

great (and certainly wealthy) private universities could puzzle over 'why we can be so rich and feel so poor'.

Consequences of austerity

The consequences of austerity, whether absolute or relative, can be felt by either the producer (the university or other HEI) or the consumer or client (the student and to some degree the parents), or most likely both. When it affects the institution, austerity may be manifested by

- loss of institutional capacity to respond to change;
- loss of academic, research or other staff, particularly the best staff, lower staff allegiance and morale (due to declining salaries), or loss of much of the time and attention of teachers or researchers as they are forced to 'moonlight' elsewhere to maintain real wages;
- erosion of equipment, including computers, laboratory equipment and library materials; and
- deterioration of physical plant, and inability to expand physical capacity to keep up with increasing enrolment.

The impact of austerity on students depends on the institutional response to its shortfall of revenue. If the institution (or the government) responds to a lack of sufficient public revenue by increasing tuition fees, especially if these increases are unmatched by means-tested grants and/or available and affordable student loans, the effects will be felt predominantly by middle- and lower-income students, who may be forced

- to move to part-time student status and seek part- or full-time employment (if this is even possible);
- to continue full-time study, but still seek part-time or even full-time employment, often to the detriment of their studies;
- to attend, or move to, an institution within commuting range of their parents' home to cut down on the expenses of student living (again, impossible in many developing countries due to the lack of nearby institutions and difficulties of transportation);
- to decide against higher education altogether, or drop out (perhaps intending only a temporary 'stop out'), or even to cease pursuing an academic track in high school, all due to a perception of the financial unattainability of higher education.

If, on the other hand, the institution (or the government) responds to a lack of sufficient public revenue by capping enrolments, particularly in the most

sought-after public institutions, the effect on students will be a shortage of places and disappointed student applicants, almost certainly to the detriment of those less academically prepared – who are almost certain to be disproportionately from weaker secondary schools and probably from lower socio-economic or rural backgrounds. And, if the country has limited its public university capacity but responded to the pressures for mass higher education by allowing and even encouraging a demand-absorbing private sector (as in many east Asian and Latin American countries), the consequences of capacity limitation will be felt mainly by those aspiring students who neither are bright enough to get into inexpensive but increasingly selective public universities nor have sufficiently affluent parents to be able afford a private alternative.

Imperatives of revenue diversification

The classic response to conditions of austerity in higher education is to combine measures for greater efficiency (for example economies of scale, eliminating duplication, closing low priority operations, increasing both student/faculty and student/staff ratios) with revenue enhancement by diversification. The remedy of revenue diversification follows from the cost-sharing perspective (Johnstone, 1986; Johnstone and Shroff-Mehta, 2000), which views the costs of higher education as shared by five parties: (1) the government, or taxpayer (or the average citizen through the inflation-driven confiscation of purchasing power by governmental printing of money); (2) parents (or spouses or extended families) through tuition fees or other charges, financed from current income, past income (savings) or future income (borrowing); (3) students, also through tuition fees, charges and other costs of student living, financed mainly from term-time or summer earnings, or from borrowing (future earnings); (4) donors, from endowments, current gifts, or ‘redistributive’ tuition fees by which wealthier parents pay more so that some students or parents can pay less (a policy that may be justified on the grounds that everyone benefits from a better quality education if fee discounting attracts bright and educationally enriching students whose parents cannot afford full tuition fees); and (5) institutional entrepreneurship and the revenue brought in by the sale or lease of university assets, consultancy, research contracts or other income generation. (Each of these potential contributions is discussed in detail below.)

Cost sharing

The case for cost sharing – that is, the shift of some costs from governments and taxpayers to parents and students – as a response to worsening austerity is

quite distinct from the case that can be made for public tuition fees on the neo-liberal economic presumption of greater equity, or simple fairness: that is, that those who are reaping considerable private benefits from a public good (especially one that is consumed disproportionately by the more affluent) should bear at least a commensurate share of the costs. This case for cost sharing because of a sheer need for revenue is also quite separate from the presumption of a greater institutional efficiency and responsiveness when universities are forced to compete for students. While these classic theoretical rationales for revenue diversification seem entirely valid to the author, they also remain ideologically contested, and the imperative for revenue diversification can rest quite well simply on the need to surmount the virtual certainty of insufficient governmental, or taxpayer, revenue.

Enhancing revenue from parents and/or students can take one or more of the following eight main forms, depending on the country and its policies:

Introduction of tuition fees (where higher education was formerly free). This occurred, for example, in China in 1997, Britain in 1998 and Austria in 2001.

A very sharp rise in tuition fees (where tuition fees already existed). A shift toward greater cost sharing requires that the rise in tuition fees be greater than the rise in institutional costs generally, in order for the government's, or taxpayer's, share to be reduced, and the parent's and/or student's shares to rise commensurately. This has been the case recently in the US, where many state governments have failed to maintain their former 'shares' of public university expenses.

Changing admission policies to favour students who can pay. In the US, this increasingly widespread practice is called enrolment management: a technique of enhancing net tuition fee revenue by rationing scholarships, or tuition fee discounts, to those who can truly help the institution – for example, the very brilliant or the very talented – and concentrating otherwise on those students who can afford to pay full fees.

Maximizing enrolments of fee-paying students. Similar to the above, this is a 'shift' or 'tilt' toward those whom the institution is legally allowed to charge for tuition. This is increasingly the practice in Russia and other countries (many from the former Soviet Union) in which students have a legal right to free higher education, but in which the definition of those students who are so entitled can be narrowly construed – for example, to only those first-time

students who pass the entrance examination with the requisite score – all others being ‘free game’ for tuition fees. Although the government limits the proportion of fee-paying students, there are so many ‘loopholes’ in the law that more than 25 per cent of all Russian university income is said to come from tuition fees – this in a country that nominally guarantees students a free higher education (Bain, 1998).

Imposition of fees or ‘user charges’ for student accommodation or food (particularly in institutionally provided and formerly heavily subsidized halls of residence or refectories). This has been happening in China and in several African countries where subsidized living costs were said by the World Bank to absorb the bulk of many governments’ higher education budgets (World Bank, 1994). In the Nordic countries (Sweden, Norway, Finland and Denmark), where higher education remains ‘free’, the private costs are exclusively the costs of student living, which are often very high in those countries, and which are ‘shared’ neither by the taxpayer nor (at least officially) by the parents. They are thus borne entirely by the students, largely in the form of student loans (although these are indirectly subsidized by the taxpayer in the form of low interest rates or other repayment subsidies).

Reduction of student grants or scholarships. This is sometimes accomplished simply by ‘freezing’ grant or loan levels, or by holding them constant in the face of general inflation, which erodes their real value. This may be accompanied by a shift in the dominant form of financial assistance from grants to loans, as happened in the US over most of the 1980s and 1990s. Such a policy diminished the once very generous grants in Britain (which were later abandoned altogether), and similar policies have reduced the value of maintenance grants in Russia and most of the former Soviet republics, and in eastern and central Europe.

Increasing the effective cost recovery on student loans. This can be accomplished through a reduction of subsidies on student loans (similar to the diminution in the value of non-repayable grants), for example, by increasing interest rates, by reducing the ‘grace period’ when students are not required to pay interest, or reducing the numbers of loans for which repayments, for any number of reasons, are forgiven. More effective cost recovery might also be accomplished through a tightening of collection procedures, or a reduction in the instances of default, with no change in the effective rates of interest paid by those who were repaying anyway.

Official encouragement (and sometimes public subsidization) of a private higher education sector dependent on fees. A number of countries – notably Japan, Korea, the Philippines, Indonesia, Brazil and other countries in Latin America and east Asia – have avoided much governmental expenditure on higher education by keeping a limited public sector – usually elite and selective – and shifting many of the costs of expanding participation to parents and students through encouraging private (often profit-making) higher educational institutions.

Other forms of revenue diversification

Non-governmental revenue may also come from donors or from institutional entrepreneurship. Among the popular forms are:

Contract research. Contract, or sponsored, research that carries an appropriate ‘overhead’ charge can finance supplemental faculty salaries and new equipment, and also contribute toward general institutional and administrative costs.

Teaching high demand courses, frequently to non-degree students, with substantial tuition fees. The teaching of specialized courses may generate enough fee income to cover all marginal expenses plus a ‘profit’ for the department and sometimes for the larger institution. This is especially popular in countries that prohibit tuition fees for ‘regular’ students (see maximizing enrolments of fee-paying students, above). Where the competition is especially keen for ‘regular’ admissions, university teachers will sometimes provide private tutoring (for a fee) to secondary students preparing for the university’s own examinations.

Sale or lease of university assets. In a similar fashion, universities sometimes own large amounts of desirable land or other assets (in China, extending to factories and other businesses) that can contribute to institutional revenue. One of the issues, particularly in the former Communist countries, is the rightful ownership of university facilities. Unless there are well-developed non-profit laws, it is not clear how free a university is to sell, lease, develop (for resale) or otherwise dispose of university assets without the proceeds being claimed by the state.

Donations. Finally, universities are turning to donors and other philanthropists to supplement governmental revenue. This can include donations, including bequests (at death) or annual gifts, or donations from corporations and foundations, any of which can be designated or undesignated (that is, left to

administrative discretion) and given either for endowment or current operations.

Limitations on revenue diversification

Political and ideological opposition to cost sharing

All of these forms of non-governmental revenue are important. Yet each has limitations. Some – particularly those that seek to shift some of the higher education cost burden from government, or taxpayers, to parents and students – generate opposition that is both ideological and self-interested. Any policy that seeks to impose a new or a sharp increase in the price of a good or a service that has come to be viewed as an entitlement, especially one so seemingly noble and socially important as higher education, will be fiercely contested. The first difficulty in attempting to implement a policy of higher education cost sharing, especially where there has been a tradition of free public higher education as a virtual entitlement to all academic secondary school leavers, is to surmount the almost inevitable ideological and political opposition. Although the politics of cost sharing are particularly country specific, three factors buttress this opposition and thus strengthen the political and ideological limitations to cost sharing as a form of revenue diversification:

Politicization of cost sharing. Clearly, when opposition to tuition fees becomes an important political plank, especially for an opposition party (which is almost always more able to take vocal stands against inherently unpopular policies like taxes, tuition fees or user charges), governments will feel constrained, especially when students are politically active and influential.

Absence or inadequate provision of means-tested grants or student loans. Opposition will be far greater (and properly so) when tuition fees are first adopted or sharply raised in the absence of some form of financial assistance to those who are most likely to be denied access to higher education by such a shift in the cost burden.

The failure (or the perceived failure) of the shift of costs to bring any benefits to current or future parents and students. An increase in tuition or other fees is more likely to gain at least some acceptance if it can be perceived as helping to finance an expansion of places, and thus of access, or financing improved on-campus living conditions or new academic equipment. In the absence of such a perception, the shift of costs to parents and students may be regarded as

benefiting some other public good (perhaps an unpopular one, such as the military) or going to line the pockets of a supposedly corrupt government or university administration.

Technical limitations to parental cost sharing

Beyond the political and ideological challenges to cost sharing, particularly in developing countries, are some essentially technical limitations. Two of these apply to the expectation of parental contributions. The first is the difficulty of determining and verifying parental ability to contribute. Establishing a reasonable parental contribution requires not only accurate measurement tools, but also a determination of the level of income (or combination of income and assets) at which financial responsibility ought to begin, as well as the rate at which the expected contribution should increase with increasing measured ability to contribute. But 'financial ability to contribute' is a complex and elusive concept, even with a high degree of voluntary willingness to comply. Furthermore, income and assets are relatively easy to disguise, as all countries that make extensive use of income taxes have discovered. Only the US, the UK and a few other advanced industrial countries have developed both a culture of voluntary tax compliance and the technical means to verify incomes so that measures of 'ability to pay' might be generally trusted. In most countries (and in virtually all less industrialized countries) the determination of 'ability to pay' – or its converse, 'eligibility for need-based assistance' – can be only crudely approximated by such indicators as parental education, occupation (especially if it is a governmental job), type of housing, and other indicators of relative affluence or poverty.

A second problem (actually a set of problems, also essentially technical) in connection with the shift of higher educational costs to parents is the duration of this presumed obligation and the related issue of financial dependence and independence. An assumption of greater financial contribution from parents assumes that the student is appropriately financially dependent – at least to the limit of the parents' ability to contribute. But what if the 'child' is a young adult, several or many years out of secondary school who only now wants to enter a college or university? Are the parents still financially responsible? For how many years, or for how many degrees, or through what levels of higher education does this expected parental financial responsibility continue? What of the complications of divorce or 'non-custodial parenthood'? What if the parent or parents simply refuse at some point any longer to support the child (or the young adult) further for higher education? Or what if the student refuses the parents' financial assistance, but then wants to qualify for need-

based assistance? Should such a refusal, whether by the child or by the parents, oblige the taxpayer to replace the missing parental contribution? Or should such a choice (on the part of either the child or the parents) preclude the student from receiving 'need-based' aid on the grounds that governmental policy must reinforce the bedrock assumption of cost sharing, that parents are financially responsible (within some necessary limits) for the higher education of their children? None of these questions is unanswerable. But together they reinforce the need for, and the difficulty of constructing, consistent policies that will be perceived as fair and workable in any particular country or culture. And these limitations reinforce the politically and culturally situated nature of such policies, reminding us that what works in the US or Germany might well not work in China, Indonesia, Ethiopia or Brazil.

Limitations on student cost sharing

The attempt to supplement governmental with student revenue is quite different from the attempt to obtain parental revenue, both in its theoretical rationale and in its implementation. A student share requires either real part-time employment opportunities (that is, employment that does not require government subsidy and also does not interfere unduly with academic progress) and/or student loans (or graduate taxes) with some real cost recovery – that is, with a present discounted value of anticipated repayments that is approximately equal to the amounts lent or deferred.

The limitation on part-time employment is that there are, especially in less industrialized countries, few part-time jobs that are both accessible to the students and not academically intrusive, and that do not depend on governmental subsidy (which obviates the purpose of the cost sharing to begin with). The problem with student loan programmes (again, especially in less industrialized countries) is that the anticipated cost recovery is so low – frequently only a small fraction of the amount lent. This is due to the combination of high defaults, excessive interest rate subsidizing and very high administrative costs, all of which are presumably amenable to policy reforms, but all of which are both politically and technically difficult (see Zideman and Albrecht, 1995). Furthermore these limitations are over and above the underlying financial and employment difficulties that beset university graduates in many countries, leaving little income for the discharge of indebtedness, even if they are fully inclined to repay their loans (Johnstone and Shroff-Mehta, 2000).

A number of countries, including the UK – possibly intrigued by claims of great success from Australia's Higher Education Contribution Scheme (see the

article by Bruce Chapman and Chris Ryan in this issue) – have instituted income-contingent repayment schemes, buttressed by incorporating the collection of student loan repayments within the official governmental machinery of tax withholding or pension contributions at the point of wage payment. However, this course requires an efficient, highly inclusive and politically accepted system of income taxation and pension withholding: characteristics found in very few countries, and probably in none of the less industrialized countries. In addition, the inability of income contingent loan plans to tap a private capital market makes the loans, particularly at the outset of a programme, almost entirely dependent on governmental revenue – again partly obviating the purpose of the loan programme. Thus, while student loans must remain an important part of any cost sharing scheme that purports to tap the students for a portion of the costs of their higher education, there are few examples of loan programmes that have brought substantial relief to their governments and taxpayers for the support of higher education. (The US, Canadian and Swedish plans are possible exceptions, although the Swedish plan is designed mainly to shift cost not from the government but from parents, who are not officially expected to contribute to the costs of their children's higher education.)

Limitations on entrepreneurship

Entrepreneurship has the potential to contribute not only to university revenue, but also to the quality and responsiveness of the curriculum and even the teaching. Clark (1998), in his study of five entrepreneurial European universities, claimed evidence that the entrepreneurial spirit extended even to the so-called heartland departments – the humanities and social science departments that are not generally thought of as market oriented or able to augment revenue from the sale of their services. Court (1999), in his study of what he termed the 'quiet revolution' at Uganda's Makerere University, cited the enhancement of faculty salaries, in turn slowing the exodus of academic staff, as the most important impact of faculty and institutional entrepreneurship.

There are, however, at least three possible limitations, or 'downsides', to entrepreneurship. The first is the potential for entrepreneurial activities to divert staff and institutional time and attention from the core mission and activities of the institution. Clearly, some entrepreneurial activities only enhance the university's mission: particularly those that provide new research and practice opportunities for both academic staff and students. However, when staff attention is drawn to activities, the main purpose of which is simply to augment salaries, both the students and the institution can lose. Given the

very great amount of autonomy enjoyed by the academic profession, the pervasive absence in many countries of clear rules for what are and are not appropriate staff activities away from the classroom, and the very low levels of remuneration in so many countries, it is not surprising that there are abuses. (What is needed, but what is also more difficult than generally assumed, is for there to be clear policies regarding the time that faculty staff are expected to be on the campus, in their offices or laboratories, and available to their students and colleagues.)

A second limitation is the potential for entrepreneurial attractions to be in actual substantive conflict with the academic canons of scholarly integrity. This can occur (at least in appearance) when a funding source has a vested interest in the results of the research that it is funding. The compromise of academic values does not have to be so blatant as the outright falsification of evidence or suppression of findings. The very decisions of what to investigate (and perforce what not to investigate) can be affected by funding sources with vested interests – including government agencies. Alternatively, the academic compromise can come in the form of limitations on dissemination of the findings. The only way to be altogether free from all such potentially compromising influence is to be free from the need for any revenue from discretionary sources – which we have already established as completely unattainable. The best protection for academic values is probably the combination of clear rules and enforceable transparency in all contracts and transactions.

A third limitation to entrepreneurship is the inherently uneven distribution within the academy of entrepreneurial possibilities, and the tendency, therefore, for academic entrepreneurship to widen the gap between the haves and the have-nots – mainly between the sciences versus the humanities, the applied versus the basic, and the politically *au courant* versus the esoteric. For academic entrepreneurship to be institutionally beneficial, there must be a recognition that the revenue-generating parts of the institution have acquired this capability at least in part because of the academic reputation (for example, for quality and integrity) that the entire institution has built up over many years. In short, the departments of management, computer science and English can market themselves in part because of an academic reputation that has been built up over the years by the those of, say, mathematics, history, anthropology and ancient languages. Indeed, most of the applied fields with entrepreneurial potential continue to draw intellectual and methodological sustenance from departments and staff with little immediate value in the marketplace. Thus, all departments should receive some benefit from the marketability of

management, computer science and English through an appropriate cross-subsidization. But this, again, requires clear rules and sensitive attention to the balance between the need to reward the staff most engaged in entrepreneurial activities and the rest of the institution. None of these limitations in itself is sufficient to deny the need for more staff and institutional entrepreneurship. But it is well to keep in the public mind these limitations and potential 'downsides', lest government come to believe that all staff in all departments and universities can live as can the 'marketable few'.

Limitations on donations

To most institutions in most parts of the world, donations – from alumni, corporations, foundations, or merely wealthy and generous 'friends' – represent in theory the most attractive kind of 'third stream' revenue. No source of revenue is quite as benign and reliable as revenue from unrestricted endowment, once the institution has it. However, getting sufficient endowment (or the less reliable and also the more costly counterpart, which is yearly revenue from current giving) to provide a substantial portion of the institution's operating and capital needs is formidably difficult. Truly unrestricted endowment – the kind that provides a reasonably predictable revenue stream in perpetuity, for whatever purpose the governing authority deems advisable – comes from money that has been invested, with only the income (sometimes plus a reasonable portion of capital appreciation) available for operations, so as to preserve the real (that is inflation-adjusted) value in perpetuity. But this means that for each dollar of predictable annual revenue stream there must be approximately \$20 of endowment (assuming the trustees spend only a prudent 5 per cent of the portfolio's total return). Or, expressed another way, for each dollar that the institution might be fortunate enough to raise with absolutely no restrictions on its use, the governing board or leadership of the institution must put away and invest 95 cents if it is to build endowment. In the absence of endowment, the institution must raise again next year (and every year thereafter) the same amount as it raised and spent this year.

To raise significant amounts of revenue from private donations requires four elements:

- donors with substantial wealth who have been carefully cultivated, sometimes for many years, and who are prepared to give the donation to the HEI – as opposed to all other claimants and good uses that are probably also cultivating the same potential donors;

- a culture of philanthropy, including widespread acceptance of an obligation to give (in so far as one is able) to the college or university from which one graduated or which one otherwise believes to be creating real social value;
- well-maintained records on the names and addresses (and if possible, the 'giving potential') of alumni and potential 'friends' – which requires staff and other institutional expenditures; and
- favourable tax treatment of the donations – ideally with the amount of the donation deducted from otherwise taxable income, thus reducing the real sacrifice to the donor and effectively shifting some of the 'cost' of the donation to the government via its forgone tax revenue. (This, of course, presumes a workable income tax system and substantial voluntary tax compliance on the part of the potential donors.)

These are substantial limitations. A handful of institutions, generally 'elite' universities, may get lucky and find a wealthy alumnus or 'friend' who is willing to give a very large donation, maybe even enough to begin an endowment. But most colleges and universities will have to spend a good deal of time and money simply to begin the necessary first steps of reconstructing past alumni records, cultivating their alumni and potential 'friends' (that is, making them proud of 'their' university), and getting them used to the idea that annual donations or a large bequest in their will is an appropriate expectation.

There are, of course, corporations and foundations capable of making donations. However, there are not enough to reach more than a small number of (probably elite) universities. More seriously, corporations and foundations generally want to fund something specific that neither the institution nor the faculty staff are likely to be able to do, or wish to do, in the absence of their contribution. They generally do not wish to give unrestricted revenue, to be used at the discretion of the governing board or institutional leadership – which is exactly what the institution needs in order to fill the gap left by declining governmental revenues. In fact, it is not uncommon for the acceptance of a restricted gift actually to cost the institution money (in the sense of constituting another drain on otherwise unrestricted revenues), in spite of the advantages and new benefits that the gift may make possible.

In short, philanthropy, or a reliance on donors, is a potentially important source of non-governmental, or third stream, revenue. However, its ability to make up for serious shortfalls in governmental revenue, particularly in the short term, and in the absence of the conditions noted above, will be unevenly distributed and limited. It will generally make the already affluent and successful more so. It can make a difference in a few instances between mere institutional survival and real excellence. It can enable change. And it needs to

be vigorously pursued. But without a combination of wealthy friends and alumni, a culture of giving, and the favourable tax treatment of philanthropy, it will not effectively make up for the widespread diminution of governmental revenue to higher education.

Conclusion

Austerity is endemic to higher education as the natural trajectory of higher education costs over time outpaces the likely trajectory of available revenue. While this general condition applies for high- and low-income countries alike, it is especially true in countries experiencing heavy enrolment pressures from high birth-rates and low current tertiary participation rates – conditions found particularly in the low-income, less industrialized world. Austerity is further exacerbated where the per capita GDP is low to begin with and where the ability of government to tax or to borrow is also low. For all of these reasons, the financial viability of higher education, including both the viability of individual institutions and the ability of the system as a whole to accommodate legitimate enrolment pressures and to maintain accessibility, depends in large part on the ability of higher education to diversify its revenue base – specifically, to lessen its dependence on the government. This situation explains the worldwide trend toward cost sharing and other forms of revenue diversification.

This article has stressed limitations on revenue diversification. This is not to diminish the importance of cost sharing, academic entrepreneurship and the cultivation of donors. But these measures, while absolutely essential, are also complex, technically complicated and frequently accompanied by unintended (and sometimes undesirable) consequences. Higher education needs the continued and dependable support of public revenue. Revenue diversification must not be thought of as a replacement for governmental, or taxpayer, support, but as an essential and theoretically appropriate, if limited, supplement. Some institutions and some students will stand to gain more from cost sharing and revenue diversification than others. And some students and parents, compared with students and parents in the past, when public revenue seemed abundant and higher education was ‘free’ (at least for the fortunate few), will legitimately observe that they are having to pay for a highly valued service that was previously financed by the general taxpayer. But the times are indeed different, and totally ‘free’ higher education is simply not likely to be seen in countries trying to solve all of the other public problems of the early twenty-first century and attempting also to accommodate half or more of their youth in tertiary education.

So the message of this article is that governments and HEIs must continue seeking ways to expand non-governmental revenue to higher education – but they must remember as well the limitations, complexities, and unintended consequences of diversifying sources of finance, and maintain higher education as a priority requiring a continued commitment of public attention and public tax revenues.

Notes

D. Bruce Johnstone is University Professor of Higher and Comparative Education at the State University of New York at Buffalo, Director of the Center for Comparative and Global Studies in Education and Director of the International Comparative Higher Education Finance and Accessibility Project. <http://www.gse.buffalo.edu/org/IntHigherEdFinance> E-mail: dbj@acsu.buffalo.edu.

¹ This article is drawn from the Lee Hysan Lecture given at the Chinese University of Hong Kong in May 2001.

² The term is used to refer to former Communist governments now introducing market mechanisms and other economic reforms.

References

- Bain, Olga (1998). 'Cost of higher education to students and parents in Russia: tuition policy issues', paper presented at the Annual Meeting of the Comparative and International Education Society, Buffalo, March 1998.
- Baumol, William J. and William G. Bowen (1966). *Performing Arts: The Economic Dilemma*, New York, The Twentieth Century Fund.
- Bowen, William G. (1968). *The Economics of Major Public Universities*, Berkeley, Carnegie Commission on the Future of Higher Education.
- Clark, Burton R. (1998). *Creating Entrepreneurial Universities: Organizational Pathways of Transformation*, Oxford, Pergamon Press, published for the IAU (International Association of Universities) Press.
- Court, David (1999). 'Financing higher education in Africa: Makerere, the quiet revolution', Washington, DC, The World Bank (mimeo).
- Johnstone, D. Bruce (1986). *Sharing the Costs of Higher Education: Student Financial Assistance in the United Kingdom, the Federal Republic of Germany, France, Sweden and the United States*, New York, The College Board.
- Johnstone, D. Bruce (2001). 'Those "out of control" costs', in Philip G. Altbach, D. Bruce Johnstone and Patricia J. Gumpert (eds.), *The Enduring Legacy: In Defense of the American Public University*, Baltimore, Johns Hopkins University Press.

- Johnstone, D. Bruce and Preeti Shroff-Mehta (2000). 'Higher education finance and accessibility: an international comparative examination of tuition and financial assistance policies', Center for Comparative and Global Studies in Education, State University of New York at Buffalo. (Also available at <www.gse.buffalo.edu/org/IntHigherEdFinance>).
- Task Force on Higher Education and Society (2000). *Higher Education in Developing Countries: Peril and Promise*, Washington, DC, World Bank (a joint World Bank–UNESCO project).
- World Bank (1994). *Higher Education: The Lessons of Experience*, Washington, DC, The World Bank.
- Ziderman, A. and Albrecht, D. (1995). *Financing Universities in Developing Countries*, London and Washington DC, Falmer Press.