

Give students tax-breaks for financing their own university studies

The problems of financing university education remain the same everywhere. And the difficulties facing South Africa do not differ substantially from those experienced by any other country.

Typically, governments attempt to mitigate the rising costs of education through subsidies, bursaries or loans. The idea is to make education more affordable. But inevitably governments end up redistributing wealth from those with lower incomes to those with higher incomes.

As can be expected, the average university student comes from a family with an income that is above average. Government financing programmes therefore typically take wealth from those that have little of it and give it to those that are better off.

South Africa also has a problem that many other nations don't have – the brain drain. So we end up redistributing wealth to finance a university education only to find that the recipient packs for Perth or some other foreign destination, certificate in hand. Many who benefit from a South African education are therefore now paying taxes in other countries.

Various proposals have been suggested to stop this drain on South Africa's taxpayers, including mandatory work schemes for specific professions such as physicians and dentists. But this compulsory service has little likelihood of working. It merely adds another incentive for newly-qualified professionals to skip the country. Other nations will not assist in preventing the exodus, as they are quite willing to have South Africa subsidise their medical systems and other skills requirements. And almost the only way to prevent students from leaving is to arrest them shortly before graduation and incarcerate them in forced-labour camps, an option no one is seriously suggesting.

The high cost of a university education everywhere makes it difficult for many students and their families to cover it. The fairest system of financing would be for those who benefit directly to pay the costs themselves. The average student seeks a degree because he or she believes, and usually rightly so, that his or her future income will increase as a result.

Students study in order to have higher incomes and greater job security after graduation. Equity alone should therefore demand that these same individuals pay the cost of their education. Naturally they will quickly point out that their education costs have to be paid before they receive the future increased incomes. Fair enough, but shouldn't they then cover the costs out of loan monies borrowed today that are paid back out of tomorrow's higher income? Those who invest for future profits often do so with borrowed funds.

The problem for the students is that while their incomes will be higher later, so will their taxes. The graduated tax system, which taxes higher incomes at higher tax rates, could easily make it unprofitable to seek an education now. This problem could be overcome by making repayments of study loans fully deductible from taxable income. The state can then stop subsidising students, universities and other educational institutions out of taxpayers' funds, so eliminating the upfront cost of higher education from the budget.

When the students graduate, the taxes they pay will be reduced for a short period of time but once their loans are repaid the revenue to the state will increase. And the taxes paid in the future would be based on higher incomes earned as a result of their improved education. Long-term state revenue should actually increase.

Experience shows that, even in developed countries like the United States, student loans guaranteed by the government are often left unpaid. And direct loans from the state have high default rates as well. Private institutions are much more careful about collecting repayments on loans so the state should avoid getting involved in the student loan business and confine itself to making the repayments less painful for students.

An additional benefit of the tax-deductible loan repayment scheme is that students will more carefully choose their courses of study. They will be inclined to choose their courses on the basis of expected returns on their investments in order to increase their later ability to repay the loans. So a frivolous course of study is less likely to be pursued. Governments that finance university educations often create students who never actually seem to join the workforce. They drag out their education, living in subsidised housing and eating at subsidised university canteens. When they finally receive their first degrees they carry on to pursue Masters degrees and then Doctorates. They impose huge costs on society and never manage to get beyond being perpetual students. This type of behaviour can only be pursued when someone else is paying the bills.

The list of potential benefits of implementing this proposal seem endless, and, most importantly, the incentives and disincentives will operate correctly. To sum up and add a few benefits not already mentioned:

- Taxpayers will not carry the burden of upfront subsidies for university education.
- Students will have an incentive to choose worthwhile courses.
- Only those students who really intend to study are likely to attend university.
- Universities will be compelled to cut costs, improve management and minimise cross-subsidisation of courses in order to reduce student fees.
- Students will be more demanding, and universities more responsive to the needs of their student customers.
- Newly-qualified students will no longer be regarded as some form of state property.

When taxpayers finance university education, the state showers highly-valued benefits on a small minority at the expense of a large majority. And it often finds that those funds do not generate the return that is expected – at least not for the state or for society. Instead the bulk of the returns are given to the student. Letting the students finance their own education today out of future earnings seems to solve most of these problems. And it really won't matter if students ultimately live in Perth or Pretoria, since they themselves will have financed the benefits that accrue to them.

Further reading

Reekie, WD (1996) 'The university as firm: Oxymoron or a *pourparler se tirer d'affaire*?', *South African Journal of Economics*, No.4, pp.134-60.

This Briefing Paper was written by Jim Peron, a freelance researcher and writer, and first appeared on the FMF's website, www.freemarketfoundation.com.