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Financing higher education: the case for a graduate tax

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Article abstract

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FINANCING HIGHER EDUCATION: THE CASE FOR A GRADUATE TAX

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ABSTRACT

The debate whether university education should be "free" seems misconstrued. Even in a system without tuition fees, someone will have to foot the bill. This paper argues that from the viewpoint of justice, a strong case can be made in higher education for adopting the beneficiary pays principle, and for institutionalising it in the form of a graduate tax. My evaluation from the perspective of justice will focus on the comparison between a "free" university system funded through the general tax system on the one hand, and one financed through a graduate tax on the other. On the beneficiary pays principle defended here, the regressive nature of the general-tax-funded higher education system renders it unjust. Furthermore, I believe we have three reasons to favour a graduate tax in practice. First, I will suggest that it does a better job at implementing the beneficiary pays principle. Second, I will argue that even though the distributive outcome of a corrected general-tax-funded education may be just, it is unlikely to be perceived to be just. A third point of comparison between the two approaches to fund higher education will be international mobility, which will reinforce the case for a graduate tax from the viewpoint of justice.

RÉSUMÉ

Le débat portant sur la question de savoir si l'éducation universitaire devrait être « gratuite » paraît mal fondé. Même un système sans aucun frais de scolarité doit bien faire acquitter la facture par quelqu'un. Cet article soutient que du point de vue de la justice, un argument solide peut être établi en faveur du principe du bénéficiaire–payeur en éducation supérieure, ainsi que pour l'institutionnaliser sous forme d'impôt gradué. Ma perspective se concentrera sur la comparaison entre, d'une part, un système universitaire « gratuit » financé par le système fiscal général et, d'autre part, un système financé par un impôt gradué. Sur la toile de fond du principe du bénéficiaire–payeur que je soutiens, la nature régressive du financement par impôt général rend cette dernière option injuste. En outre, je crois que nous avons trois raisons de favoriser dans la pratique un impôt gradué. Tout d'abord, je démontrerai qu'un tel impôt met en application le principe du bénéficiaire–payeur de meilleure façon. En second lieu, je soutiendrai que même si les conséquences distributives d'un système d'éducation financé par un impôt général étaient justes, il aurait peu de chances d'être perçu comme étant juste. Un troisième point de comparaison entre les deux approches de financement de l'éducation supérieure sera la mobilité internationale, qui renforce l'argument pour un impôt gradué du point de vue de la justice.

INTRODUCTION

"There ain't no such thing as a free lunch." Popularised in his discipline by economics Nobel Prize laureate Milton Friedman, this expression highlights the fact that economic goods and services inevitably come at a cost. Even though certain commodities are supplied at zero direct cost to the consumer, as is the case in some countries for public libraries or museums for instance, someone has to bear the cost to provide them. Against this background, the debate whether university education should be "free" seems misconstrued. Even in a system without tuition fees, someone will have to foot the bill. Who should that someone be?

This paper argues that from the viewpoint of justice, a strong case can be made in higher education for adopting the *beneficiary pays* principle, and for institutionalising it in the form of a graduate tax. The OECD reports that the benefits from higher education in terms of relative earnings are considerable. Among those countries which report gross earnings, the earnings premium for people aged 25 to 64 years with tertiary-level education, relative to upper secondary education, ranges from 24% in Denmark to 135% in Hungary. The corresponding figure for Canada is 36% (cf. OECD 2005, table A9.1a) Under a graduate tax, alumni whose income passes a specified threshold pay a certain percentage towards funding university education. The proposal itself is not new. In fact, it is Milton Friedman (1945 and 1962) who, true to the spirit of the opening sentence above, is generally credited with the idea.

My evaluation from the perspective of justice will focus on the comparison between a "free" university system funded through the general tax system on the one hand, and one financed through a graduate tax on the other. On the *beneficiary pays* principle defended here, the regressive nature of the general-tax-funded higher education system renders it unjust. Of course, graduates under this institutional arrangement bear part of the costs, but their studies are subsidised by those who do not attend university. In principle, this injustice could be corrected through a more progressive income tax, even if only approximately. However, I believe we have three reasons to favour a graduate tax in practice. First, I will suggest that it does a better job at implementing the *beneficiary pays* principle. Second, I will argue that even though the distributive outcome of such a correction may be just, it is unlikely to be *perceived* to be just. This perception, in turn, undermines the political feasibility of such a scheme – zero tuition fees combined with an accordingly more progressive income tax. A third point of comparison between the two approaches to fund higher education will be international mobility. Given the continuing increase in the cross-border mobility of qualified graduates especially, I will once again make a case for a graduate tax from the viewpoint of justice. Importantly, I will limit my case for a graduate tax to undergraduate studies. My recommendations may prove less robust at the graduate or doctorate level, and I therefore hesitate to extend my defence of a graduate tax to the financing of these advanced degrees.

Before, however, I turn to two preliminary elements of my argument. Section 2 sets out the criteria of justice that I believe we should employ to evaluate the financing of higher education. Section 3 offers a reminder of the potential justifications for government interventions as well as a brief synopsis of what I see as the four main policy options. It justifies my concentration on the comparison between a general tax model and a graduate tax, leaving aside other modes of financing like tuition fees combined with scholarships, a universal student loan programme, or a deferred fee payment. The substantive arguments that feature in the comparison between the general tax model and a graduate tax are put forward in section 4. Finally, section 5 considers, and for the most part rejects, a series of objections to the case for a graduate tax from the viewpoint of justice.

TWO PRINCIPLES OF JUSTICE IN FINANCING HIGHER EDUCATION

Let me begin by stating the principles that I will use in this paper to evaluate the different ways to finance higher education:
Equal educational opportunities for individuals of equal ability;
The beneficiary pays principle to achieve a just repartition of the costs and benefits of higher education.

What justifies these principles? All stages of education from primary school to university contribute to better the prospects of an individual to access other kinds of social advantages later on in life, like income, positions of responsibility, or further education. The social distribution of educational opportunities is dominated by two considerations that pull in opposite directions. On the one hand, we want to promote the advancement of the most talented members of society to ensure that positions of responsibility in the community are filled by the most competent people. On the other hand, we want to ensure that the gap between different levels of talent does not grow too wide, an objective that might necessitate special efforts directed towards the less talented. Our weighing of these considerations may well result in an educational system that offers unequal opportunities to individuals of different abilities;[1] hence the qualifier "for individuals of equal ability" in my first principle. The kinds of unequal opportunities that this principle wants to rule out are ones based on social background, including race, religion, or the family's financial situation. The last of these is particularly relevant in our context. Children of rich parents should not have an advantage in access to university compared to their equally talented peers from poorer families. This kind of principle of equal access to higher education is widely accepted, and I will therefore take the liberty not to defend it any further here.

On the face of it, my second principle may seem equally uncontroversial. After all, *it would be unjust to make individual A pay – even in part – for a social advantage that is conferred on B, and from which A does not benefit*. This does not preclude that the *beneficiary pays* principle may be outweighed in practice by other considerations. Redistribution from the privileged to the unprivileged in society, for instance, may license the financing of certain social programmes – like training schemes for the long-term unemployed – by those who do not directly benefit from them. However, such cases do not undermine the principle itself.[2] Therefore, in defending the *beneficiary pays* principle, I shall presume agreement on the italicised phrase at the beginning of this paragraph. If you disagree with that statement, then you might as well stop reading here. Note, however, that there is plenty of room for disagreement even once we accept this statement. I shall distinguish two kinds of disagreement.

1) Interpretations of the *beneficiary pays* principle in the context of higher education are likely to differ. Some will say that higher education bestows both private and public benefits. In other words, though A does not receive a university education or the pecuniary as well as non-pecuniary benefits it entails for B, A still benefits from living in a society with people as well trained and educated as B. The university education of some creates a positive externality for others.

To see why I disagree with this conjecture, consider the form these externalities are supposed to take. There are two possibilities here. First, someone might point to the benefits of the specialised skills conferred by higher education. Yet, does the fact that we can rely on particularly well-trained doctors or lawyers constitute a positive externality? No. After all, the quality of their training is reflected, *ceteris paribus*, in the price of the services they provide. Second, and more plausibly, the defender of the above position might see the externalities in some more fundamental features of our society. Higher education, so the claim would go here, contributes to civil society and its culture: a society that is characterised by mutual respect, a high level of literacy, a sophisticated public debate, and so on. These features combine into a public good, whose existence benefits all members of society. I agree with this last sentence, but I doubt the specialised training and education at university contribute to this public good. I agree with Friedman (1962, 98) that the case for such "neighborhood effects" is much stronger at the level of primary and secondary schooling than in the context of higher education.

I need to add an important qualifier here. As opposed to the skills of its graduates, the knowledge produced by universities as research institutions *does* represent a public good, and as such generates considerable positive externalities. The benefits of having public intellectuals are an example for such an externality. However, this paper is not about financing university *research*, but about financing higher *education*.

Suppose you disagree with the conjecture of the last two paragraphs that university education does not generate a special public benefit. Does this undermine the *beneficiary pays* principle? I think not. *Prima facie,* it would show that *part* of the costs of higher education should be covered through general taxation, but it would not exempt graduates from paying for the private benefits they derive from their studies. The only possibility to make the stronger argument that university education should be subsidised through general taxes beyond the public benefits it generates would, as outlined above, have to produce a consideration that outweighs the application of the *beneficiary pays* principle. One candidate here is the declaration of higher education as a so-called merit good. I will provide a definition of this concept in section 3, where I will argue that although the merit good character of higher education justifies government intervention, it does not license a subsidy through general taxation.

2) The second kind of disagreement that acceptance of my two principles does not preclude concerns the basis and size of the payment to be made by the beneficiary. There are two basic options: Either the graduate should pay for the costs of her education or she should pay a certain percentage of the benefits she draws from it. As we shall see in the next section, this is what distinguishes a deferred fee payment from a graduate tax. The two are similar in that they both propose a payment by the student himself, albeit a deferred one that is conditional on the graduate passing a certain income threshold later in life. The two differ in their approach to the question of what should determine this payment. A graduate tax, as I have explained, is based on the principle of *beneficiary pays*, whereas the deferred fee payment relies on the presumably less demanding principle of *user pays*.[3] As I will set out in more detail in section 3, *user pays* requires the graduate to repay the costs of her education, whereas under *beneficiary pays* she pays a percentage of her subsequent earnings.

You might think that if graduates pay the costs of their education, they should be entitled to the benefits. This is how the market mechanism functions. Consumers pay the market price of a good, even if the utility they derive from this good is considerably higher – hence the term 'consumer surplus.' The next section will include a brief reminder why this reasoning fails in the context of higher education. However, let me emphasise that my main objective in this paper is to make a case for a graduate tax over a higher education system that is funded through general taxation. The fundamental difference here lies in the fact that the former imposes a direct and special payment onto those who attend higher education, whereas the latter does not. On this issue, advocates of a deferred fee payment side with proponents of a graduate tax. Although they disagree on other questions, I will largely bracket those disagreements here.[4]

To sum up this section, I hope to have provided a sufficiently solid foundation of the *beneficiary pays* principle for the purposes of this paper. I have defended the position that the beneficiaries of higher education should make some sort of direct payment, while acknowledging the possibility that this principle may in application be outweighed by other considerations. I have not offered any conclusive argument for why this direct payment should be based on the benefits derived from rather than on the costs of one's higher education. Though the next section will fill this lacuna at least somewhat, a defence of a graduate tax and the underlying *beneficiary pays* principle against criticism from this angle is not the main purpose of this paper.

Let me add a few remarks on the relation between justice and other values or objectives that are likely to influence our approach to policy issues in higher education. Clearly, we want the system by which we finance higher education to be *efficient*. In one sense, this desideratum is entirely compatible with justice.[5] A system of higher education is efficient if it maximises the overall skill set and knowledge base of all members of society for any given level of funding. A graduate tax, implementing the first principle of justice above, namely *"equal educational opportunities for individuals of equal ability,"* produces this outcome. Why? Because students will only enter higher education if they expect a positive return, in other words if the expected value of their skills exceeds the expected cost in terms of the graduate tax. However, this is not the only dimension of efficiency of our system of higher education. We may think, for instance, that there are differences in efficiency according to whether the institutions of higher education are administered publicly or privately. I believe that these other dimensions of efficiency can be separated from the question of financing higher education that preoccupies me in this paper.

A second objective that plays an important role in current debates on financing higher education concerns the level of funding. Several industrialised countries have experienced a decline in the funds available per student.[6] The introduction of a graduate tax whose revenues are earmarked for spending on higher education has the potential to reverse this trend. This assumes, importantly, that the price elasticity of demand for higher education is relatively low, i.e. that demand for higher education will not drop significantly in response to the introduction of higher private costs in form of a graduate tax. If we are correct in thinking that the private benefits from higher education are substantial, low price elasticity seems a reasonable assumption to make. Under the *status quo*, on the other hand, spending on higher education is frequently pushed down the priority list of governments by health care or primary and secondary education. The *beneficiary pays* principle seems compatible with the objective to increase funding for higher education.

HOW TO FINANCE HIGHER EDUCATION?

This paper defends a graduate tax as the preferred mode to finance higher education. The purpose of this section is twofold. First, I will provide a reminder of how we justify government intervention in higher education in the first place. Second, I will describe the functioning of a graduate tax as well as of the three principal policy alternatives: funding via the general tax system, via tuition fees combined with publicly funded scholarships and bursaries, or, finally, via a universal student loan programme / deferred fee payments. Note that the kind of justification we give for government intervention is likely to influence the policy we choose to structure this intervention.

In economic theory, government intervention in higher education is justified in virtue of education being a so-called merit good. The definition of a merit good is far from straightforward, yet it is uncontroversial that it "cuts across the traditional distinction between private and public goods," and denotes "situations where evaluation of a good (its merit or demerit) derives not simply from the norm of consumer sovereignty but involves an alternative norm." (Musgrave, 1987)[7] The reason for switching from one evaluative norm to another is based on a broad social consensus that, if left to the market, the provision of the good in question would be below what is socially desirable. In education, three factors are usually considered to contribute to this shortfall. To determine what form government intervention should take, it is useful to briefly rehearse these factors and to verify whether they come into play in the context of higher education, and if so how:

Positive externalities: Externalities of an economic transaction between parties are effects on third parties who do not partake in the transaction. These effects are not reflected in the market price for the commodity in question. Therefore, in the case of a positive externality, individuals equating their private marginal benefit with the private marginal cost will consume less than the optimal amount of the commodity in question.

Do such externalities exist in education? As I have already argued in the previous section, the case for the existence of such externalities is much stronger at the level of primary and secondary education than in the context of higher education. To my mind, this argument cannot justify government intervention in higher education.

Information asymmetry: For some goods, we feel justified to adopt a mild form of paternalism in deviating from the norm of consumer sovereignty to govern their allocation. The lack of medical knowledge on the part of the patient, for instance, legitimises the delegation of decisions about treatment and medication to the doctor. Myopia on the part of healthy individuals justifies the imposition of obligatory public health insurance. In education, the fact that children cannot yet make well-informed decisions about how much education to "consume," combined with the fact that their parents or tutors may neglect the responsibility to look after their interests, underlies our case for compulsory primary and secondary education. However, this argument is much harder to sustain with regard to 18 to 20-year-olds faced with a decision about whether to enter higher education or not. Information asymmetry cannot justify government intervention in higher education either.

Failure of the capital market:[8] When you want to buy a house, your bank will most likely offer you a mortgage on the condition that the house secures your loan. If things turn sour and you cannot pay back the money, the bank will take the house instead. The same logic does not apply to investments in human capital for two principal reasons. First, “[i]n a non-slave state, the individual embodying the investment cannot be bought and sold.” (Friedman 1962, 102) And second, even if that were possible, the risks in human capital investment are considerably higher than those in other forms of capital like real estate or machinery. In other words, attending university does not guarantee a higher income, and banks are not prepared to bear this risk. Based on this failure of the capital market to allow people to borrow the money needed to finance their studies, Friedman (cf. 1962, 104-7) and others have called for government intervention.

I believe this third reason for government intervention is the only one that applies to higher education. Moreover, note the complementariness between this argument and the first principle of justice set out in section 2. Without government intervention to offer student funding in one way or other, access to higher education would be influenced by the financial background of prospective students. This would violate the principle of equal educational opportunities for individuals of equal ability.

I now turn to the question of what form should this government intervention take? There are four main policy options:

1) Funding via the general tax system

This is the classical model of financing higher education, which for a long time has been the dominant model in most European countries and, to a lesser extent, in Canada. On this model, university education is funded through the general tax system, which usually displays some degree of progressiveness.[9] Since there are no tuition fees, this funding model respects the call for equal access for any given talents made by my first principle of justice. However, and this is the worry that motivates this paper, funding higher education through the general tax system violates the *beneficiary pays* principle. Though university graduates contribute more thanks to their higher earnings, those who never attend university still contribute something for a service from which they do not directly benefit. As I have argued in section 2, this is only acceptable if there are some considerations to outweigh the *beneficiary pays* principle in application.

2) Funding via tuition fees combined with publicly funded scholarships and bursaries

In some countries, notably the United States, factors like the desire to reduce the size of government have led to a market for higher education in which private suppliers play a more important role. According to this model, private universities, and to some extent their public cousins, too, receive a considerable share of their budget through fee payments from students. Obviously, this system would violate the principle of equal access for any given talent if no corrective measures were taken to help students from poorer families finance their studies. Therefore, the fee-based model is usually complemented by generous scholarship and bursary programmes.[10] However, note that this still violates my first principle of justice. After all, scholarships and bursaries are either selective or contingent on some sort of means testing. The latter is likely to be both costly and invasive. In sum, whereas young adults with rich parents willing to finance their studies will have access to higher education unconditionally, the same is not true for their peers from poorer backgrounds.[11] I am sure more could be said on this model, but for the remainder of this paper, I shall not consider it.

3) Funding via a universal student loan programme / deferred fee payments

One way to correct the injustice of the previous model is to introduce a universal student loan programme, in which all students have access to a loan at a zero or very low rate of interest. Several countries, among them Canada, rely at least partly on this mode of financing. Yet, critics have pointed to the psychological burden on graduates who leave university with a considerable amount of debt at a time in their lives when they also face other financial commitments, like the costs of setting up a family, buying a house, and so on. This has led to a slight modification of this third model. Instead of paying off debt, graduates make a deferred fee payment *conditional* on their post-graduation earnings passing a certain threshold. The difference lies in the conditional character of the repayment, which eases the psychological burden on the graduates. The 2004 UK Higher Education Act, for instance, implements a system of this sort in the United Kingdom; Australia uses deferred fee payments, too. (cf. Barr 2005)

4) Funding via a graduate tax

From a purely financial point of view, the disadvantage of the deferred fee payment model is that it is not self-financing. Not all graduates attain the threshold of income at which they have to repay, and even if they did, the government still has to subsidise the favourable interest conditions it offers. One alternative form of deferred payment able to overcome this problem is a graduate tax. Once again, payment of the tax is conditional on the graduate attaining a certain threshold of income. In contrast to the deferred fee payment, however, the basis of the payment is not the fee but the actual income earned. In order to be self-financing, the graduate tax rate needs to be raised to a level where its revenues cover the costs of *all* students in higher education – both of those who reach the specified income threshold from which the graduate tax is payable and those who do not. This shows that the graduate tax relies on a form of redistribution among university graduates.[12] As with any tax, one has to keep in mind that tax payment is not a reliable indicator for tax incidence (e.g. for information about who ends up footing the bill to pay the tax). It may well be, for instance, that graduates are able to pass on some of the graduate tax to their employers. For a numerical example of how a graduate tax works, let me direct you to Carmichael (2005). At the time of writing of this paper, a system relying only or even mainly on a graduate tax has yet to be implemented.

In practice, we mostly see combinations of the first three of these models, relying in part on general tax money, in part on tuition fees and scholarships, and in part on student loans or deferred fee payments. This paper argues that from the viewpoint of justice, we should rely on a graduate tax instead, or at the very least add it to our policy mix.[13]

As I have already emphasised, my focus lies on what I perceive to be a fundamental injustice of the general tax model compared to the other three: It violates the *beneficiary pays* principle.[14] Yet, why also discard models 2 and 3? I consider that the model combining tuition fees with scholarships and bursaries is not an option due to its violation of the equal opportunities for equal abilities principle. What about deferred fee payments? Why not *user pays* instead of the *beneficiary pays* of the graduate tax? Here is the short answer to this question: If someone makes a risky investment, they expect a return on this investment and will not be content with simply getting their money back adjusted for inflation. Moreover, from a normative perspective, we consider that the investor is entitled to a return from her investment. As set out in the section on the failure of the capital market in higher education, investment in human capital is a particularly risky investment. Therefore, if the state – read: the community – makes this investment, this amounts to buying a share in an individual's earning prospects (cf. Friedman 1962, 103) and should yield a return that reflects this risk. On this interpretation, the graduate tax does not "take something away" from the individual, but merely represents a transfer payment from the recipient of the investment to the investor. The interest of the government in this case would not be to maximise the return from this investment, but only to make higher education pay for itself – something that a deferred payment scheme based on the *user pays* model is unable to achieve.

I am aware of the fact that a lot more can be said on the comparison between deferred fee payments and a graduate tax (cf., for instance, Barr 2005, Carmichael 2005, Lemelin (manuscript), or The UK Department for Education and Skills 2003). If my principal aim in this paper were to defend a graduate tax over a deferred fee payment, I would indeed have to delve into this discussion. However, my preoccupation here is the violation of the *beneficiary pays* principle by the general tax model, the model that still plays an important role in the higher education systems of many countries. In defending a graduate tax against *this* model, I take the liberty to set aside a more detailed discussion of *beneficiary pays* versus *user pays*.

GRADUATE TAX VERSUS THE GENERAL TAX MODEL

Looking at my argument thus far, a defender of the general tax model may well be unimpressed. A progressive tax system, he will argue, can easily accommodate the *beneficiary pays* principle. We simply have to increase the degree of progressiveness to the point where those who would be affected by a graduate tax pay the same amount of money through the income tax system in virtue of their higher incomes. Note that this operation can only ever be a proxy for two reasons. First, the counterfactual result of what would have happened under a graduate tax will always be imprecise, since it is impossible to know the changes in incentives and behaviour that introducing such a tax would have entailed. Second, income tax is levied on all earners, and therefore an increase in the degree of progressiveness does not manage to isolate the beneficiaries of higher education.

However, the defender of the general tax model will deny that its proxy-character should count as a weakness. On the contrary, he will point out that aiming for a more accurate fiscal instrument would be overly ambitious. It is easy to see why. People can end up in a high-paying job for many different reasons. They might be talented, motivated, born into a family that cared for their education and had the means to do so; they might make choices that steered them towards well-paying professions, attend university, or simply be luckier than others. In reality, all these factors, and many more, combine into an intricate causal web, which we will never have the epistemological means to disentangle.[15] We will never be able to know *to what extent* attending university is affecting a particular individual's income. It might be the case, for instance, that those attending university are on average more talented and that this difference goes a longer way in explaining their higher incomes than their higher education. In individual cases, the positive correlation between attending university and higher income might not even hold at all. In light of these facts, using subsequent income as the tax base for a graduate tax aimed at taxing the benefits from higher education can itself never hope to be more than a mere proxy. In this case, why complicate the tax system further by introducing a graduate tax? A position along the lines set out in this paragraph is for instance expressed by Philippe van Parijs (2004, 4).

So which of the two proxies should we favour? The general tax model, despite its inability to isolate the beneficiaries of higher education – or the graduate tax, despite the imperfections of the underlying *beneficiary pays* principle in practice? I see three arguments in favour of the latter.

BETTER PROXIES AND WORSE PROXIES

First, there are differences in precision even among proxies. I think we have reason to believe that a graduate tax will go a longer way towards implementing the *beneficiary pays* principle than the general tax model. Recall the considerable income premium that those with a higher education enjoy over their peers.[16] Granted, not the entire premium is due to attending university. Granted also that some of the premium can be viewed as compensation for the opportunity costs of entering work a few years later.[17] However, we do not need to be able to disentangle the causal web of all contributing factors behind higher earnings in order to ascertain that those who attend university on average benefit considerably from doing so, and that providing the service underlying this benefit is costly. The graduate tax model is sensitive to this correlation, whereas the general tax model is not. Though still an imperfect implementation of the *beneficiary pays* principle, because there will be individual cases for whom the correlation does not hold, this is what makes the graduate tax a better approximation of the principle's requirements than the general tax model. This difference will be reflected in the distributive outcome generated by a graduate tax and the general tax model respectively.[18]

THE PERCEPTION OF JUSTICE

At this point, defenders of the general tax model are likely to interject that the difference in distributive outcome is likely to be negligible, and therefore does not warrant introducing yet another complication into the tax system. This brings me to my second argument in favour of a graduate tax. We can summarise it with a slogan that has been defended across a diverse range of contexts in political philosophy: *Justice not only has to be done, it has to be seen to be done.*

The perception of justice being done is of fundamental importance in two closely related ways. First, if the members of a community perceive the institutional arrangements that govern the distribution of social advantage to be unjust, they will most likely refuse to accept them. Second, the perception of living under a just social arrangement promotes the internalisation of the principles that govern this arrangement. (cf., for instance, Rawls 1999, chapter VIII) In other words, the implementation of justice feeds on the perception of justice.

What influences this perception of justice? Clearly, the appeal of a particular distribution of social advantages depends on the *reasons* we have to believe that this distribution is just. These reasons, in turn, usually contain information that goes beyond the mere outcome of a distribution. Suppose I ask you to evaluate two distributions of income, distribution $X = (10,20,30)$ and distribution $Y = (20,20,20)$ from the viewpoint of justice. This is hardly possible without some information about how these distributions have come about.

With regards to the financing of higher education, I have argued that one central reason to accept a particular distribution of both income and higher education as just is that it respects the *beneficiary pays* principle. As we have seen, the general tax model can accommodate this principle as far as its distributive outcome is concerned. However, I believe that the likelihood of this distributive outcome to be perceived as respecting the *beneficiary pays* principle and, therefore, its likelihood to be perceived as just, are considerably lower compared to the graduate tax model. Evidently, this is an empirical, and therefore contingent claim. My aim cannot be to try and prove its validity, but all I can hope for is to show why and under what circumstances it is plausible to believe it holds.

My argument here relies on one of the fundamental insights of Liam Murphy and Thomas Nagel in their book on taxes and justice, *The Myth of Ownership* (2002). The authors observe that in contemporary societies, taxes levied by the government tend to be perceived as an infringement of individual (or corporate) property rights. As they poignantly put it, "[T]he natural idea that people deserve to be rewarded for thrift and industry slides into the much broader notion that all of pre-tax income can be regarded as a reward for those virtues." (Murphy and Nagel 2002, 33) This gives rise to the myth of ownership, the idea that I have an entitlement to my pretax income and that the state, via taxation, is taking away something that belongs to me. I agree with Murphy and Nagel that this way of conceptualising taxation is fundamentally mistaken. Instead of seeing taxation as an infringement of property rights, we should think of taxation as part of the social arrangements that *define* property rights.

Given the prevalence of the myth of ownership in contemporary societies, increasing the progressiveness of income taxes to finance higher education seems like a long shot for two reasons. First, even if the political motivation were to accommodate the *beneficiary pays* principle, pursuing this objective through an adjustment of income tax rates would in all likelihood not be perceived as just, and regarded as "a further infringement of ownership." In other words, the myth of ownership represents a stumbling block for implementing the *beneficiary pays* principle via the general tax model. Second, and partly as a consequence of the first point, increasing the progressiveness of income taxes looks politically unfeasible in a political climate where the trend has been away from progressive taxes. For two extreme cases, consider the reduction in the top marginal income tax rate in the UK from 98% in 1979 to 40% in 1988, or the fall of the corresponding US rate from 70% at the end of the 1970s to 28% in 1986.

The notion of ownership identified by Murphy and Nagel may be a myth that does not stand up to critical evaluation, and yet it has a significant influence on fiscal policy. Perhaps it is precisely because it seems so blatantly unjustified from a normative point of view that we tend to underestimate this influence.

A graduate tax arguably fares better on the criterion of being perceived as just. The principal reason is that it applies the *beneficiary pays* principle openly. Moreover, it tackles the myth of ownership head on by arguing that from an investment perspective, part of the income of a university graduate, i.e. part of the benefits from higher education, are in fact "owned" by the society that financed this investment. You may object that this second argument is contingent on the myth of ownership. Indeed, it is. Yet, this does not undermine its force as an argument in favour of a graduate tax here and now. We would be better off if the myth of ownership could be dispelled, but I agree with Murphy and Nagel that this task is all but straightforward.

FINANCING HIGHER EDUCATION AND INTERNATIONAL MOBILITY

Accommodating the *beneficiary pays* principle to the general tax model presupposes that the beneficiary does not leave the country. Especially with respect to highly skilled university graduates, this is less and less true. The labour market they enter after their studies is no longer confined to national boundaries. Therefore, the probability that they end up paying income taxes in a different country from the one that bankrolled their education is significant. If the flow of university-trained labour across borders were symmetrical, that is to say if for every country the number of people leaving and arriving after their studies were roughly the same for any given level of qualification and pay, this would not pose a problem of justice over and above those already identified in previous sections. In practice, however, this phenomenon of post-higher-education-brain-drain afflicts some countries more than others.

One of the many factors that influence these movements is the income tax structure. If tax rates in the country where one has attended university are relatively high, there exists an incentive to leave.[19] It is often said, for example, that one of the advantages of London as a financial centre are its relatively low income taxes, which allow the resident firms to draw in talent from elsewhere. Despite being merely anecdotal, this example helps to illustrate the phenomenon.

From the point of view of the *beneficiary pays* principle, the problem is obvious. Under the general tax model, the migrant worker does not pay for the service from which she has benefited in terms of a higher income. This is unjust. Given the asymmetry of migration flows, the fact that she does contribute to the higher education system of her new country of residence can only count as a partial mitigation of this injustice.

Some advocates of the general tax model, notably Philippe van Parijs (2004, 6) share this worry. Van Parijs suggests that the most effective solution to the problem would be to develop a "sentiment of gratitude and an attitude of loyalty vis-à-vis the collective entity to which one owes the privilege." (6, my translation) I agree that this might be the most effective solution, but at the same time it appears somewhat utopian. Moving for purely fiscal reasons may be objectionable, but I doubt that the moral hazard involved here can be overcome.

However, the moral hazard could be eliminated at least with respect to the financing of higher education through the introduction of a graduate tax payable to the country that invested in one's higher education. Once again, the graduate tax represents the ideal instrument for implementing the *beneficiary pays* principle.

I need to make an important qualification here. A graduate tax is not only able to address the violations of the *beneficiary pays* principle that are the result of international mobility, it actually *has to* do so. If Canada were to introduce a graduate tax, for instance, it would have to ensure that its claim on a certain portion of its graduates' income is enforceable abroad. In other words, Canada would have to sign a series of agreements with other countries guaranteeing their co-operation in collecting the graduate tax. Implementing such a web of co-operation with other states is unlikely to be a straightforward exercise. Cynics might say that it is just as utopian as the proposal by van Parijs mentioned earlier. I do not intend to underestimate the challenges that lie in implementing a graduate tax. In fact, I will mention several others in the next section. However, I believe that none of these obstacles are insurmountable and that the case for a graduate tax from the viewpoint of justice is strong enough to warrant a serious attempt at overcoming them.

OBJECTIONS

As parts of the last section already indicate, a graduate tax does have weaknesses, too. In this section, I will discuss what I consider to be the most serious objections to the graduate tax model. I will also mention, very briefly, a series of other criticisms that have been put forward and spell out why I deem them less worrisome.

Sliding into a particularist approach?

In financing public and merit goods, we usually do not ask whether an individual contributor actually benefits from the service offered. We do not inquire into her particular circumstances. A graduate tax would break with this pattern, and therefore raises fears that it might put us on a slippery slope towards a society in which people opt out of the public services they do not consume and benefit from. Especially the privileged, whose tax payments contribute most towards the funds for public and merit goods, seem to have an incentive to opt out and thereby avoid cross-subsidising others in society. This would cause the quality of public services to deteriorate.

To see why this fear is unjustified in the case of a graduate tax, consider two cases. First, let us imagine the reasoning of a well-off university graduate. We'll call her Angela: "I accept the proposal of a graduate tax. In fact I, too, believe in the justice of the *beneficiary pays* principle that underlies it. But I think we should apply it consistently. Take my case. I send my children to a private primary and secondary school, and they therefore do not benefit from the public money spent on this type of schooling. I believe I should get a tax deduction!" Second, Angela's neighbour, Bert, who does not have children at all, argues: "I do not have children and therefore do not consume any educational services. I should get a tax deduction."

‚One needs to distinguish three issues here. First, Angela has a point, but not one that puts us on a slippery slope towards widespread opting out of the system. Angela's children receive *one* primary and secondary school education each, but she pays twice. This is unjust. However, instead of giving Angela a tax deduction, the right response is for the state to fund private schools on an equal footing with public schools. In fact, in some countries like France, this is standard practice. Doing so does not amount to a particularist approach but, on the contrary, to considering the interests of all members of society equally.[20]

The second issue raises the more general question whether non-beneficiaries should contribute at all. The answer here will depend on the justification we give for government intervention in the provision of the good or service in question. As I have argued in section 3, there are significant differences between primary and secondary education on the one hand, and higher education on the other. The former create significant positive externalities and are subject to asymmetries of information, which is not true of higher education. These features require a general tax model for primary and secondary education, whereas a departure from this system is warranted for higher education. This is why childless Bert should pay taxes towards the former but not the latter.

Third, it is worth emphasising that there is nothing wrong in principle with particularism as understood here. Economists have long struggled to devise a mechanism that would allow us to measure the differential strengths in preferences for public goods, so that we could charge those with relatively strong preferences for, say, road infrastructure more than those who value this particular good less (cf. Groves and Ledyard 1977). In the case of public goods, though such differential pricing would be just (cf. also Murphy and Nagel 2002, 85), these efforts usually break down because people have an incentive to understate their preferences. In education, however, we do not face the problem of non-excludability, and differences in consumption can therefore translate into differences in price. This paper has argued that for higher education, where significant differences in consumption exist, the *beneficiary pays* principle requires us as a matter of justice to charge differentially by levying a graduate tax. This kind of particularism is to be welcomed.

Positive externalities after all.

You might disagree with my position in sections 2 and 3 that higher education does not generate positive externalities. Recall two central elements of my argument. First, in contrast to primary and secondary schools, which do indeed lay the foundations for a civil and cultured society, the specialised training and education of university confers exclusively private benefits. Second, this statement only applies to higher education and does not extend to university research. Someone who disagrees and holds that higher education does generate positive externalities will demand that the public at large contribute towards its financing. In fact, this demand is compatible with and even supported by the *beneficiary pays* principle.

To arbitrate this conflict, we would need detailed studies of where the benefits of higher education fall. The fact that universities confer private benefits seems beyond doubt. However, even if the studies found that there are public benefits as well, this would not lead me to drop my case for a graduate tax. All it would show is that *to the extent* that higher education generates public benefits, it should be financed via the general tax system; and *to the extent* that higher education generates private benefits, it should be financed via a graduate tax.

So much for what I consider to be the most serious objections, which also appear to be the most interesting ones from a philosophical point of view. To finish, let me briefly run through some more practical objections to a graduate tax:

Levying a graduate tax would prove administratively difficult and costly.
Reply: Yes and no. Integrating a graduate tax into our income tax statement could be straightforward. Addressing the issue of international mobility discussed in section 5 might admittedly prove more difficult.

What to do with university dropouts? Do they pay graduate tax or not?
Reply: Their tax rate should be adjusted according to the proportion of their degree they have completed. The same income threshold applies.

Does deferred payment through a graduate tax create perverse incentives? People may decide to take several degrees and then make sure never to pass the income threshold that would require them to pay the graduate tax.
Reply: Such free riding will be difficult to avoid altogether. However, note that the same incentives also exist under the general tax model and have not proven to be problematic.

Should the graduate tax payment not reflect the costs of people's respective studies? Should the lawyer or the doctor not pay more than the mathematician or the philosopher?
Reply: This would be the case under the deferred fee payment model. I have (briefly) indicated in section 3 why I favour a graduate tax. Admittedly, more would need to be said on this issue.

How to integrate private universities into the scheme?
Reply: Graduates from private universities would be subject to the same tax, and their institutions would receive the same funding per student as their public counterparts.

Introducing a graduate tax is problematic, since it generates costs straight away, but the first revenues only come in once the first participating students graduate and pass the defined income threshold.
Reply: It is indeed the case that the scheme would have to be financed in advance by the government until it breaks even.

Milton Friedman's biggest worry when he introduced the idea of a graduate tax was that the scheme would turn into a "political football," with politicians giving in to the temptation to use the graduate tax revenues for purposes other than higher education. (Friedman 1962, 107) A related worry would be that the graduate tax revenues versed towards higher *education* crowd out public funding for university *research*.
Reply: This is indeed a danger, but one that threatens all models of financing higher education and university research. One partial solution would be to earmark the graduate tax revenues by law for spending on higher education only.

CONCLUSION

Today, higher education increasingly serves as a passport to the most lucrative positions in society. A system under which the passport holders are subsidised by the rest of society is not only regressive, but also violates the *beneficiary pays* principle. The general tax model to finance higher education is such a system.

I have presented three arguments in favour of a graduate tax model, which fares better from the viewpoint of justice. First, even though it still is a proxy, a graduate tax goes a longer way towards implementing the *beneficiary pays* principle. Second, and contingent on the current perception of income taxation as an infringement of individual property rights, the graduate tax is more likely to be perceived as just than the general tax model. This means it compares favourably with the general tax model when it comes to political feasibility. Third, a graduate tax offers the possibility to accommodate the effects of increased international mobility of university graduates, though doing so may prove difficult in practice.

The strong case for a graduate tax as an exclusive means to financing higher education rests on the assumption that higher education creates private benefits for those who attend university, but no positive externalities for society at large. However, even if this assumption is questioned, a more moderate argument still calls for adding a graduate tax to the policy mix to finance higher education *to the extent* that it produces private benefits.

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NOTES

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[1] For an insightful treatment of these considerations, cf. also Nagel (1997, 315).

[2] If consideration A *outweighs* considerations B, this does not question the importance of consideration B. By contrast, if consideration A *undermines* consideration B, the latter no longer enters into our decision process at all.

[3] Whether it is in fact less demanding financially depends on the rate one chooses for the graduate tax, as well as on other details of either scheme.

[4] For an in depth comparison of a graduate tax with a deferred fee payment, cf. for instance Barr (2005), or the document "Why not a Pure Graduate Tax?" published by the UK Department for Education and Skills.

[5] Cf. also Carmichael (2005, 541).

[6] Note, however, that this trend has been reversed in the more recent past. Cf. OECD (2005, table B1.4).

[7] Merit goods like health care or education are similar to private goods in two respects. Consumer A is able to exclude others from consuming the same good, and there is rivalry between A's consumption and that of others. The same does not hold for public goods, which are defined by non-excludability and non-rivalry in consumption.

[8] For an excellent and more detailed treatment of this point cf. Friedman (1962, 102-3).

[9] A particular tax is called progressive if the average tax rate increases with individual revenue. It is called regressive if the average tax rate decreases with individual revenue. In order to assess the progressiveness or regressiveness of an entire fiscal system, one needs to take into account public expenditure as well as taxation.

[10] Scholarships put more emphasis on academic merit, whereas bursaries are handed out based on means testing.
[11] This statement holds on the assumption that well-off parents are *willing* to finance their children's education.
[12] As one of the referees for *Les ateliers de l'éthique* rightly pointed out, this could be regarded as a violation of the *beneficiary pays* principle. After all, those who pass the threshold end up cross-subsidising the higher education of those who do not. This is correct. However, I would maintain that the violation of the *beneficiary pays* principle here is less serious than in the case where someone who never went to university pays towards higher education. The cross-subsidisation among graduates is less objectionable because no one is paying for a *kind* of service that he did not benefit from.
[13] Incidentally, I suspect that a policy mix is likely to be the right approach to the financing of postgraduate studies, which I am setting aside in this paper.
[14] Though models 2 and 3 are not founded on the *beneficiary pays* principle, they in effect make those who receive higher education *directly* bear the resulting costs at least to some extent.
[15] Cf. also Ronald Dworkin (1981, 313): "It might be helpful […] if we were able to find some way of identifying in any person's wealth at any particular time, the component traceable to differential talents as distinguished from differential ambitions. […] But we cannot hope to identify such a component, even given perfect information about people's personalities. For we will be thwarted by the reciprocal influence that talents and ambitions exercise on each other."
[16] Cf. statistics cited in the introduction to this paper.
[17] For an account of the importance of this factor, cf. Clément Lemelin (manuscript). Friedman and Kuznets (1945, 84) estimate that this factor can only account for a relatively low percentage of the income premium for professional workers. This hypothesis would have to be tested again for today's data.
[18] For an in-depth analysis of the distributive effects of different modes of financing higher education, cf. Lemelin (1998, chapter 16).
[19] To some, perhaps negligible, extent the lower income tax rates elsewhere may even become possible thanks to the fact that many of the workers of the country in question are educated on other countries' expense.
[20] Financing higher education: the case for a graduate tax page