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## Position Paper on Higher Education in Latvia

### 1. Executive Summary

FICIL believes that the higher education system is in need of serious reforms if it is to become internationally competitive, prevent brain drain ('human capital flight'), and turn into a key driver of Latvia's economic development. The reforms should focus on changing the financing model of higher education and promote consolidation of the higher education system.

### 2. Recommendations/Suggestions

In order to help the higher education system fully realize its potential, FICIL recommends that the Latvian government implement a number of reforms focusing on:

- (i) *Consolidation of the system of higher education.* The reforms should aim to replace the present system of many fragmented and, for the most part, mediocre higher education institutions with a few internationally competitive research universities. If possible, the reforms should aim to preserve regional dimension of higher education in order to promote development of the regions.
- (ii) *Considering a radical change in the higher education financing model,* moving away from per-student subsidies towards funding universities through targeted infrastructure support, grants to fundamental research, and co-financing for industry-oriented applied research. However, the reform must also retain a sufficiently wide choice of educational programs, ensuring availability of at least one program in any field of higher education (broadly defined), independent of the number of students.
- (iii) *Ensuring availability of student loans* in order to ensure that students from lower socio-economic backgrounds have equal opportunity to obtain higher education. At the moment, rather low use of student loans signals problems with access to such loans. FICIL recommends that the government launches a comprehensive inquiry to understand the factors preventing the use of student loans. Given likely capital market imperfections, the government may need to weigh the options to correct such imperfections, perhaps via subsidised interest rates, or loan guarantees, focusing on capable students from lower socio-economic backgrounds.
- (iv) *Considering tax incentives for companies* as a way to encourage companies to invest in the human capital of their employees. It is well known that competitive private companies are deterred when it comes to investing in their employees. It might be hard to realise a return on investment in human capital because an employee may easily be headhunted by a competing company.
- (v) *Developing a new model of research financing* along the lines of the world's best practices, e.g. National Science Foundation. Creating open competition for research grants. Minimise the risk of favoritism by making sure at least half of the evaluating committee consists of foreign academics.

- (vi) *Adopting modern methods of quality assessment*, largely based on success in publishing in international peer-reviewed journals.
- (vii) *Promoting internationalisation of Latvian higher education and science* in order to ensure international competitiveness. Introduce incentives to make the student body more international, therefore attracting students from other countries. If possible, seek ways to ensure graduate students spend a semester in the world's top schools so as to be exposed to the highest standards of academic excellence. Consider running master's level programs in English only to ensure competitiveness of these program's graduates. Actively recruit visiting foreign faculty. Aim to have at least 5-10% of any faculty to be foreign visiting faculty.
- (viii) *Increasing the role of employers' organizations in determining the content of vocational training programs*. It is a well known concern that graduates of many vocational schools are ill-equipped for the actual needs of the labour market.

### 3. Rationale

After the bursting of the real estate bubble and its painful consequences, Latvia is in search of a new model that would ensure rapid but sustainable economic growth. Study after study confirms that investment in human capital is the key to innovation, technology adoption and, ultimately, economic growth.

However, in spite of a large number of higher education institutions and impressive numbers of students per capita, there is mounting evidence suggesting that the Latvian system of higher education is not up to the task of enabling rapid economic growth. The system of higher education is inward –oriented and, as shown by many rankings, mediocre if judged by international standards. Measured by a number of English language publications in international peer-reviewed journals, Latvia is seriously underperforming in both natural and (especially) social sciences – even compared with Estonia and Lithuania.

An internationally competitive system of higher education ensures adequate investment in human capital and may even be an exporter of higher education. On the contrary, a weak system of higher education suppresses economic growth and results in brain drain ('human capital flight'), as the brightest individuals leave to better universities in other countries and then become part of these countries' work force. Thus, excellence in higher education is of paramount importance in an increasingly global and competitive economy.

Latvia clearly has too many (34) higher education establishments for a country of its size. In 2008, these institutions have produced a mere 145 SCI (science) publications per million of population in international peer-reviewed journals, as compared with 2,941 in Sweden and 610 in Estonia. Thus, on average, these are rather mediocre institutions, as measured by their research output. Shutting some of these institutions down and consolidating others into a few research universities will save substantial administrative resources and help focus on areas in which Latvian scientists are internationally competitive.

At present, the financing model of higher education combines massive per-student subsidies to a number of state universities and higher-education institutions with an arbitrary set of financing for a large number of scientific institutions. However, this model is not economically sound. The problem is that higher education by itself is not a classic *public good*, i.e. something that is non-excludable and non-rivalled in consumption. Thus, there is no *a priori* reason for the government to provide it. Recipients of higher education enjoy substantially increased lifelong earnings, which should be sufficient motivation to invest in higher education. As pointed out by the World Bank experts, providing 'free' higher education may distort individual choices and also amounts to

redistribution to the middle and upper-middle classes. In contrast, research is a public good, in a sense that a private market in the absence of government intervention would under-provide it. It follows that the government should minimise, possibly abandon altogether, per-student subsidies (i.e. budget places) and channel the money towards subsidising research and the infrastructure that is necessary to conduct such research. We suggest a financing model based on three pillars: (i) grants for fundamental research; (ii) targeted grants for the purchase of crucial research infrastructure (e.g. laboratory equipment, computers, software); (iii) co-financing for industry-oriented research, with a condition that funding is matched by the industry. Thus, FICIL broadly supports the recommendations of the World Bank to cut financing for “budget places”.

Clearly, student loans should become the main vehicle to finance higher education. This makes it crucial to ensure that such loans are accessible on reasonable terms, especially for students from lower socio-economic backgrounds. Generally, there are two main reasons for government intervention in this context. Firstly, it is important that student loans are accessible to gifted individuals from lower socio-economic backgrounds. This will improve social mobility and reduce poverty and social exclusion. Secondly, there are well-documented imperfections in capital markets, especially with regard to student loans, since perfect contracts on future incomes cannot be written. In the absence of government intervention, this would lead to under-provision of student loans, especially to individuals from lower socio-economic backgrounds. Thus, there is clearly room for policy solutions that may involve interest rate subsidies, co-financing, and/or loan guarantees. Such measures should be especially targeted to individuals from lower socio-economic backgrounds. Clearly, a thorough study is needed in order to determine the appropriate choice of policy instruments.

As concerns financing for research, Latvia’s main problem is its small size and lack of exposure to international academia. This greatly increases the risk that personal connections and favouritism become too important in the disbursement of research grants. Given FICIL’s recommendations for shifting a financing model towards research financing, it becomes imperative to develop an effective system of competition for research grants. It is advisable to borrow from the world’s best practices in this area, such as National Science Foundation in the U.S. Also, to overcome the risks of favouritism in a small country, evaluation should rely heavily on the role of external experts, i.e. academics from top European and American universities.

Also, there is a role for the government to help students make their choice about what educational programs to apply to. The government should strive to provide accurate intelligence on what are the present labour market needs, and what are the likely developments in the next 5 to 10 years. Thus, the authorities should focus on developing a comprehensive labour market surveying system with appropriate up-to-date tools and follow-up mechanisms.

Also, there is a serious concern that higher educational institutions, especially in vocational training, do not have sufficient incentives to tailor the content of their programs to the actual needs of the labour market. Elimination of budget place would go some way to solving this problem as it would force these institutions to compete for the students. We think that real, constructive dialogue between educational institutions and employers should be promoted. This process has already started as an initiative of the Latvian Employers’ Confederation, but more communication is needed with additional professional associations. Generally, our opinion is that employers’ organizations should play a greater role in determining the content of vocational education programs.