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**IS THERE A VIABLE ALTERNATIVE TO STATE  
FUNDING, REGULATION AND OWNERSHIP OF  
NEW ZEALAND UNIVERSITIES IN THE  
21ST CENTURY?**

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## IS THERE A VIABLE ALTERNATIVE TO STATE FUNDING, REGULATION AND OWNERSHIP OF NEW ZEALAND UNIVERSITIES IN THE 21ST CENTURY?

In a lecture that I gave at the University of Auckland earlier this year, I commented that the record of New Zealand governments had been to respect academic freedom, despite their extensive involvement with the university system, and that the more obvious threats to freedom of inquiry and expression were coming from within the institutions themselves. But I also warned that future governments may take a less benign attitude to university autonomy. Like their counterparts in Australia and the United Kingdom, they may one day insist, as owners and funders, on a greater level of control. I suggested that university academics should think about ways of protecting academic freedom by moving towards a more diverse higher education system, such as exists in the United States, which has a mixture of state and private, non-profit and for-profit institutions. However, stronger protection of academic freedom is only one of the possible reasons for moves in this direction, and by no means the most important. So I welcome this opportunity to speculate further on this topic.

Some preliminary observations are in order. First, for most of their history universities have typically been private institutions. They began as religious institutions, and the churches continued to be the main provider of higher education until well into the nineteenth century. As well, universities benefited over the centuries from state patronage. But only in the twentieth century did governments in New Zealand and elsewhere become involved with the funding, regulation and ownership of universities in a pervasive way.

Secondly, although such state involvement is common and widespread, in several countries many, sometimes most, universities are private. In Japan, 80 percent of students go to private universities; in Brazil, 60 percent. The best-known private university system is that of the United States. Although it caters for less than a third of tertiary students, it includes some of the country's most prestigious institutions, the so-called Ivy League group. Private universities are emerging also in our part of the world. Australia now has four such institutions – Bond, Notre Dame, Melbourne Private and the Australian Catholic University. New Zealand has as many as 800 registered private training establishments (PTEs), ranging from the Auckland Institute of Studies to colleges of language, interior design, hairdressing and so forth. They are typically small

institutions, with an average enrolment in 1995 of only 138. New Zealand and Australian governments have required their state universities to raise the level of private funding and they have introduced tuition fees over the last decade, though a high level of state subsidy remains in both countries, at least for domestic students. In addition, universities may raise private income from gifts or from selling their research services to private clients; the University of Canterbury has substantial endowments, while Lincoln University derives nearly half its income from private sources.

My third preliminary observation is that, in the private tertiary sector, a perceptible trend exists towards the for-profit model and away from the non-profit model. The Auckland Institute of Studies is a for-profit organisation. Chile and the Philippines have sizeable for-profit tertiary sectors. Several American universities are profit-making institutions. The DeVry Institute has traded its shares on the New York stock exchange since 1991. It has 27,000 students on 13 campuses. Tuition fees account for over 90 percent of its income, and it is reported to be able to provide a Bachelor of Science degree for half the cost of many state universities. The recently established for-profit University of Phoenix already operates in a dozen locations and on the Internet; with nearly 70,000 students it is one of America's largest universities. Of Australia's private universities, the most recently established – Melbourne University Private – is for-profit. I will come back to this example later, since it has an innovative structure that suggests a promising transition path for the privatisation of state universities.

These preliminary observations permit a first answer to the question posed in the title of this address. Viable alternatives certainly do exist to state funding and ownership of universities – that is a simple statement of fact. The important and interesting issue is whether these alternatives are preferable to the prevailing state model. It needs to be analysed under the three headings of funding, regulation and ownership as these are essentially independent issues and a variety of combinations of state involvement is possible. I will discuss each in turn.

First, funding. The New Zealand Business Roundtable re-examined the issue of government finance for higher education in a submission last year to the government's Tertiary Education Review. As we see it, government subsidies are not to be justified merely in terms of increasing participation in higher education for its own sake; given that resources are scarce, it is quite possible to have too much higher education in the sense that society would have to forgo other goods that it values more highly at the

margin. Rather, any subsidy needs to be subjected to the normal tests that are applied to government spending: does it promote efficiency or equity? More specifically, does it improve on the outcomes in terms of efficiency and equity that would emerge in the absence of a subsidy? Our analysis suggests that present levels of subsidy are too high and not well targeted, and that they encourage an inappropriate pattern and level of offerings.

The efficiency arguments for government subsidy for higher education revolve around the alleged positive externalities of such education and possible deficiencies in capital markets. If too many of the benefits of higher education accrue to beneficiaries who cannot be made to pay for them, less higher education may be produced than is desirable from the community's point of view; while if capital markets are defective, some would-be students will be unable to raise the funds they need to buy their tuition or to maintain themselves throughout their studies.

Neither argument is very persuasive. Research in education has shown that the benefits of higher education are very largely captured by students themselves in the form of the higher lifetime incomes that their qualifications command; the private incentives to obtain a tertiary qualification should be sufficient to ensure that something close to an optimal amount of higher education is produced. There is a stronger case for government subsidies for education at lower levels of education where the positive externalities may be greater.

As for capital market deficiencies, it seems implausible to argue that New Zealand's deregulated and competitive finance industry is unable to manage loans to most promising students or to find appropriate collateral among parents, potential employers or sponsors. Similar problems of lack of reputation and collateral face young people who want to establish a business. In other countries, support from parents rather than other taxpayers is often a prime means of obtaining a tertiary qualification. Part-time and vacation employment are other options.

In respect of equity considerations, the main point to be made is that blanket subsidies are inequitable in that most university students come from middle-class rather than poor families and most go on to earn higher incomes than the average taxpayer in later life. Tuition subsidies are in fact a major example of middle-class welfare in New Zealand and in general a transfer from poor to rich. If there are to be subsidies, they should

surely be concentrated on students from poor families who may otherwise be unable to access higher education. Even in this case it has to be recognised that such subsidies go to people from low income backgrounds with the greatest innate abilities and the best life prospects; those with less ability who struggle at lower levels of education are arguably still more deserving of assistance.

The Business Roundtable concluded that the efficiency argument for government funding pointed to a subsidy based on the public good element of courses. Universities should be required to assess this element just as local government is now required to assess the public and private benefit elements of its services, but we suggested that on average it was unlikely to exceed 30 percent of tuition fees. The goal of equity would be best met not by universal subsidies but by targeting disadvantaged students. The government's loan scheme should be structured along these lines. In addition, assistance could be encouraged from private sources. Universities could call on foundations and individual philanthropists to offer scholarships to students who, for various reasons, may otherwise miss out on higher education. A general move away from state welfare, particularly to middle and higher income groups, with a lower structure of taxes would allow more scope for self-reliance on the part of families and more non-government funding for those needing assistance.

What about government subsidies for the research undertaken in universities? The standard argument is that these subsidies are also justified on the grounds that they promote positive externalities. But research does not automatically produce such benefits, and the fact that the outcomes of research cannot be known in advance is no argument for public subsidies. Where research leads to higher-quality teaching, the costs should be recovered through appropriate levels of tuition fees. Research that is independent of teaching should not be charged to students. Where lines of research are known to produce positive benefits that cannot be charged for, any subsidies for them should be rigorously determined and monitored through some method of performance measurement. As well, they should not be allocated specifically to universities but should be contestable by any institution that engages in research. Much university research funding already comes from contestable sources like the Public Good Science Fund which may award funds to bodies other than universities, such as the Crown Research Institutes.

Overall, it seems that universities could derive most of their funding from private rather than government sources without any loss of, and indeed with gains in, efficiency and

equity. Efficiency is likely to be further enhanced by the greater competition that would emerge among universities if students paid for more of their tuition costs, leading to better cost control and monitoring, more flexibility and responsiveness in meeting student demand, more intensive use of assets, and more imagination in attracting bequests and endowments. Funding should, of course, be neutral between public and private institutions, and students should also have the choice of using their subsidies at overseas institutions. Such a policy would increase competition, which is seen by most observers as a key factor in the performance of the American university system.

To date there is little evidence that higher fees have unduly discouraged enrolment, no doubt because a tertiary education is a good investment for many people. At some point demand might well be sensitive to the fees that are charged, but participation rates are not a sound basis for judging subsidy levels. Like any other investment, investment in higher education should only be undertaken if the returns exceed the costs, and some argue that currently students are being encouraged into higher education who are not suited to it. The argument for subsidies must come back to efficiency and equity considerations.

The benefits of 'privatising' much university funding, then, are pretty clear-cut in my view. I believe the same can be said of the case for removing much state regulation of universities – the second dimension of state involvement that I have been asked to consider. What is involved here is not general workplace regulation – health and safety requirements, for example – but the role of the government in policing entry into the tertiary education market, determining rules for state funding, and certifying the qualifications that institutions confer.

In New Zealand, entry into the tertiary education market is strictly regulated. The name 'university' is protected by statute. An institution can only offer a degree if it meets the approval of the New Zealand Qualifications Authority (NZQA) and ensures that its teachers are engaged in research. It is proposed to formulate and adopt a minimum quality standard that is consistent with international standards. On the face of it, such regulation seems benign. Potential students appear to face serious difficulties in gathering and evaluating information about the array of qualifications available from tertiary institutions and in judging how they compare internationally: does not this call for well-formulated regulation to provide assurance of quality?

But consider some elementary axioms of the economics of information. First, information is costly to provide and to seek; producers therefore face a rational incentive to provide, and potential consumers to seek, only as much information as suits their purposes. If those incentives are absent, it is just as likely that too much information will be produced as too little. Secondly, well-known voluntary mechanisms have evolved to meet the demand for information, such as advertising, the use of brand names, reports by consumer organisations, and membership of associations that attest to quality; and successful producers earn invaluable reputations that spread by word of mouth. Thirdly, not all consumers need be well informed for a market to be efficient. If some consumers 'comparison shop' intensively and choose providers in the light of their findings, all providers will be conscious of the effects of choice and competition and other less well informed consumers will benefit from the search activities of others. All of these mechanisms are at work in education markets.

It is therefore far from self-evident that government certification and accreditation of tertiary institutions are necessary, or that government regulation can rectify any problems at acceptable costs. Indeed, government regulation can *reduce* information. Ten years ago, the Australian government ended its 'binary system' of tertiary education, which usefully distinguished between the academically inclined universities and the vocationally and technically oriented 'colleges of advanced education' (what we call polytechnics). Under the current 'unified' system, the colleges of advanced education have been renamed 'universities', thus notionally raising their status but creating uncertainty about how their products compare with those of the original universities. The market soon rectified this example of regulatory failure: Australia now has not one but two well-regarded, commercially produced, annual guides to the universities.

Artificial entry barriers and regulated definitions of quality can be serious impediments to innovation and to the efficient evolution of markets for tertiary education. They are bound to reflect the views of existing suppliers of tertiary education, enabling them in effect to form a cartel that vetoes competitive threats to its members and encourages new entrants to conform with established models. Take the requirement that teachers should engage in research. This reflects the traditional career path of the tenured university academic, who combines teaching with research. But surely a tertiary institution should be permitted to allocate gifted teachers to teaching only? Of course teaching benefits from research, but teachers can gain that benefit by reading the results

of research undertaken by other staff. It should be up to each institution to choose how to pursue its goals and to deal as it sees fit with any consequent risk to the quality and reputation of its services. As it is, the regulations make it easier for the established institutions to continue rewarding research performance much more highly than teaching performance: a major manifestation of producer rather than consumer sovereignty.

The deeper problem here is that 'quality' is a highly subjective concept, perhaps impossible to capture in any simple, unambiguous definition, and its meaning varies according to the purpose for which it is used. The assumption that quality *can* be authoritatively and clearly defined reflects the conviction, common in all the professions, that quality should be determined by the most experienced and successful practitioners. One problem is that most students are not aiming to become full-time practitioners of the subjects they study. They are studying for diverse purposes: to enhance their earning power, to change their occupations, to improve their minds, or just for the personal enjoyment of study. Different criteria of quality may be appropriate for each of these purposes. There are widely different quality standards in the American higher education market, and quality cannot sensibly be evaluated independently of cost – what matters to consumers is *value*, the quality/cost combination. A deregulated system would allow these various factors to become articulated and monitored, so enhancing the accuracy of the signals in the tertiary education market. As it is, the uniform qualification system inhibits the natural segmentation of this market, and so passes much of the cost of seeking and supplying needed information to the wider society.

It is simply not plausible to argue that a single agency, the NZQA, can do a better overall job of replicating and processing this sort of information than the market. But if the system were deregulated, the NZQA could survive on a voluntary basis if its services were valued and tertiary institutions found them to be a useful way of signalling their standards and reputation. However, those institutions would be free to seek validation from other bodies, international as well as domestic, and would be likely to do so especially if they wished to pursue multiple segments of the higher education market. New institutions would be free to offer degrees and to seek validation from other bodies, or none at all if they preferred to rely on other quality controls. The result would be a much more diverse system, with institutions facing incentives to realise their

existing comparative advantages and being free to invest in new ones, as opposed to the overwhelming incentives under the present homogenous system to replicate the norm.

The final dimension of intervention I have to address is ownership. Here there are two basic issues. The first is whether the state needs to be a provider of higher education services. The second is whether to adopt a non-profit or a for-profit form of organisation if state institutions are moved to the private sector.

On the first issue, I find it very hard to find compelling arguments for government ownership of tertiary institutions. We have seen that private universities have proved themselves to be perfectly viable, even under unfavourable terms of competition with state institutions. To be sure, private institutions are not uniformly better than state institutions, but this observation is not a reliable guide to policy, particularly when competition has taken place on an uneven playing field. We need to see whether there are sound public policy reasons for the state being an owner.

It is difficult to see any equity objectives which require state ownership. Equity concerns can be readily catered for through funding strategies and, if necessary, regulation. Any desired level of subsidy can be provided to students enrolling at competing private institutions.

Efficiency objectives would seem likely to be better achieved through private ownership. Governments can face conflicts of interest between their ownership and funding roles. They find it hard to allow institutions which they own to fail, regardless of their performance. It is difficult for governments to undertake effective monitoring, particularly of standards of teaching and research. Attempts to do so are likely to become costly and intrusive, and perhaps threaten institutional autonomy and academic freedom. Autonomous institutions would have a greater capacity to plan long-term strategies whereas this capacity is limited for state institutions by changes in governments and government policies. Institutions with greater autonomy would enjoy greater freedom in employment and remuneration arrangements and asset management. There would also be stronger incentives for performance, provided sound governance structures were established. Current governance arrangements involving councils of an unwieldy size and politicised representation of insider groups are weak, but this problem can only be remedied under state ownership by moves to downsize councils and place more reliance on owner appointments and co-opted members, which

university communities resist. Arguments that an abandonment of state ownership would mean an end to a traditional academic and 'public service' culture which would be upsetting to university staff do not seem persuasive.

For these kinds of reasons, some of which have motivated moves towards privatisation of other state-owned organisations, I believe we are likely to see governments reconsidering their ownership of universities and other tertiary institutions. Sweden is one country that has already privatised two of its tertiary institutions, one of which is a leading university, partly in the interests of encouraging greater diversity, competition and innovation in the tertiary sector.

The second and more interesting question, on which I have an open mind, is whether state institutions should be moved into a non-profit or for-profit form in the private sector. Around the world, the non-profit form has been the more common model. This may, however, have more to do with the historical origins of universities, to tax concessions granted to non-profits and to non-neutral government funding policies than to inherent aspects of their performance. One argument that is made for maintaining some existing non-profits in a North American context is that alumni donations are an important source of funding and that these would dry up if residual owners were able to appropriate profits. However, this argument seems barely relevant in a New Zealand setting where donations are a minor source of funding, where there is more emphasis on teaching than research, and where the logic of donations is dubious given existing government funding policies. It would only become more compelling if the case for government funding of universities on public goods grounds were called into question.

From the point of view of efficient performance, there are some obvious weaknesses with a non-profit model, which would typically take the legal form of a trust. New Zealand experience with trusts in industries like banking, liquor retailing and electricity suggests their performance is typically inferior to their normal commercial counterparts. Monitoring of trusts is difficult, and they are not subject to disciplines such as the threat of takeover – they share these disadvantages with state-owned institutions. As a result, managers and staff may be able to enjoy the 'quiet life' and there may be less entrepreneurship and innovation. A further point is that, contrary to some popular assumptions, non-profits do not face a lower cost of capital through not having to pay dividends; the opportunity cost of capital to them includes a normal profit and charges

for tuition or other services must reflect this element unless they are subsidised from other sources.

It is the recognised disadvantages of the non-profit model, which may also include problems of capital raising, which are generating so much interest in the emergence of the for-profit universities, like the DeVry Institute and the University of Phoenix that I mentioned earlier. Tertiary education is an expensive, labour-intensive business, and its modus operandi has remained remarkably unchanged for decades, even centuries. But modern communications technology, and especially the Internet, are creating opportunities for all that to change, and the for-profit model is the one that seems to be discovering them fastest. The international reach of the Internet means that no university is safe from the competitive threat posed by the new on-line universities. A possible future of this kind was sketched by Peter Aranson of Emory University, Atlanta, in a recent paper entitled 'Wither the Non-profits?':

It is a frightening prospect to most university administrators and faculty, but the age of for-profit colleges and universities has begun. Imagine a national university, or even a regional one that offers courses to students by videotape, CD, over the Internet, or in rented halls. The university could locate the very best lecturers in the world and commit their lectures to an electronic medium, with total, centralised multimedia support. It could establish telephone, e-mail, learnlink, and chatroom support ... .

Notice what this hypothetical example *does not* include: dormitories, food services, counseling offices, gyms, chaplaincy staff, offices of affirmative action, students organisations that all students must support, massive layers of administrative bureaucracy, libraries ... .

Notice what this hypothetical example *does* include: careful selection of faculty and student assistants for their teaching skills, close monitoring of course content and quality of lectures, careful choice of teaching materials and other indicia of performance, open admissions ... .

This vision no longer remains hypothetical. It is happening now.

This news will not necessarily be welcomed by many, perhaps most, academics. But if for-profit universities are finding ways to cut costs, remuneration for their teaching staff might rise above prevailing levels in state and non-profit universities, and opportunities for staff to become shareholders would open up. Some university staff in mid-career who have watched their salaries fall relative to the average and are wondering whether

they should ever have embarked on academic careers must surely see opportunities as well as threats from the arrival of the profit-making university.

One way of facilitating the transition from state to private for-profit status has been demonstrated by Melbourne University Private. Launched earlier this year, Melbourne University Private has been promoted by the University of Melbourne – probably Australia's leading university – in response to growing central government control over Australia's state-financed universities. It is essentially a for-profit adjunct to the University of Melbourne. It draws on private finance and has its own campus. But its undergraduate and graduate awards will be certified by the University of Melbourne, and it has negotiated access for its students to the University of Melbourne's extensive amenities. It will derive income not only from its degree courses in select subjects but also from short, customised professional training courses, research for government and business, and consultancy services. By buying access to an established university infrastructure and a well-regarded brand name, Melbourne University Private has overcome many of the policy-induced barriers to entry into the tertiary education market. As well, it will provide opportunities for staff of the University of Melbourne to undertake additional work as contracting teachers. It has naturally aroused controversy within the academic community, but it seems well placed to survive and prosper.

There is no need to advocate a one-size-fits-all solution to the ownership problem. If, as I see it, there are advantages in moving away from state ownership, some institutions or parts of them (such as MBA programmes) may be more suited to a for-profit model while others may work better as non-profits. One thing I am very clear about is that the for-profit model provides much stronger drivers for efficiency and would offer a better deal to students from the point of view of costs, as the US examples demonstrate. If students associations were seriously concerned about costs they would do well to look hard at this option, instead of engaging in mindless rhetoric about the 'marketisation' of education. The only counter-argument I have heard, and about which I retain an open mind, is that it would somehow undermine a university's academic mission. This is a nebulous assertion, and needs to be spelt out in a precise way and tested if it is to be taken seriously.

My conclusion, therefore, is that as a matter of both fact and logic there are viable alternatives to state funding, regulation and ownership of New Zealand universities. In my opinion they all offer advantages over present practices. As I see it, universities face a basic choice. They can cling to government ownership, keep advocating high levels of

government funding, and tolerate indifferent government regulation. In this scenario I believe they will face pressures for more intrusive monitoring and greater controls over time as governments respond to justifiable pressures from electorates to be more accountable for the huge resources going into higher education. Alternatively, they can opt to progressively let go the apron strings and chart their own destiny.

Universities should be exciting and innovative organisations, yet too often in my experience staff morale is low, the culture is conservative and resistant to change, good academics are frustrated by poor administration, and academic careers are becoming less attractive than opportunities elsewhere. For their part, students are facing costs of tuition that might be substantially reduced if organisations faced different incentive structures. With increasing tertiary enrolments and tax pressures on governments, universities are not likely to find governments willing to increase student subsidies, nor would this be justified. For all these reasons I believe that all parties have a stake in seeing alternatives to current arrangements vigorously canvassed in the period ahead.