

The Risks of Privatisation of Higher Education

Presentation made at the 2008 SSU Higher Education
Conference

12/1/2008

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Ladies and Gentlemen,

More than any time in recent history, the events of the last months have caused us to pause and think. The crash of the stock markets has brought once proud companies to their knees, thousands of workers blue collar and white collar alike are leaving work in the evening, not to return the following morning, and the guardians of the world's financial markets are in what can only be described as panic. Decision makers and opinion formers of every type from Nicolas Sarkozy to Alan Greenspan, have called for an examination of not only the operations but the *values* of modern capitalism.

Indeed, the indicators of the necessity for such a radical rethink are now everywhere and growing by the day. Governments have come round full circles and are buying back previously privatized institutions in terms of help given to everything from banks to telecom companies to airlines. Talk of investing in public works to stimulate the economy shows that big government is back in a serious way. I do not need to postulate the risks of privatisation to illustrate them to you today – we are living them in a very real and painful way. To put things into perspective, the cost of the financial bailout so far in Europe alone, at approximately 2 trillion Euros, would pay our entire investment in Higher Education for 16 years – that is until 2025.

If this wasn't enough, current events have given us yet more examples of why we shouldn't throw caution to the wind – and nothing illustrates this better than these men – the chairmen of the Big Three Detroit car makers which, who this week have collectively asked for 36 billion dollars – roughly half the GDP of Slovenia, in government aid to stay in business. Despite being some of the most successful and profitable companies on the planet, they failed to act responsibly – neglecting research and development, pouring money into bigger

SUVs without any worry about social responsibility when the world was begging for more environmentally friendly solutions and in short neglecting their social responsibility to act as actors in the global community and to plan for the futures of those dependent upon them for their livelihood.

All this goes to serve one point only – to borrow a phrase from pop science, the myth that privatisation and full deregulation are universally good is busted. On the other hand, despite the many anecdotes here mentioned, even in today's situation, it cannot be denied that private enterprise has brought tremendous wealth and increase the quality of life for millions of people.

Thus, if we apply this abridged reflection to Higher Education, the question we must ask ourselves is how do we ensure that such events never strike our universities – and in the context of the debate on privatisation of Higher Education it means we need to ask why should we privatise and whether the benefits and opportunities acquired by such an exercise justify the risks – which, as we are being reminded of late, can and do sometimes come true.

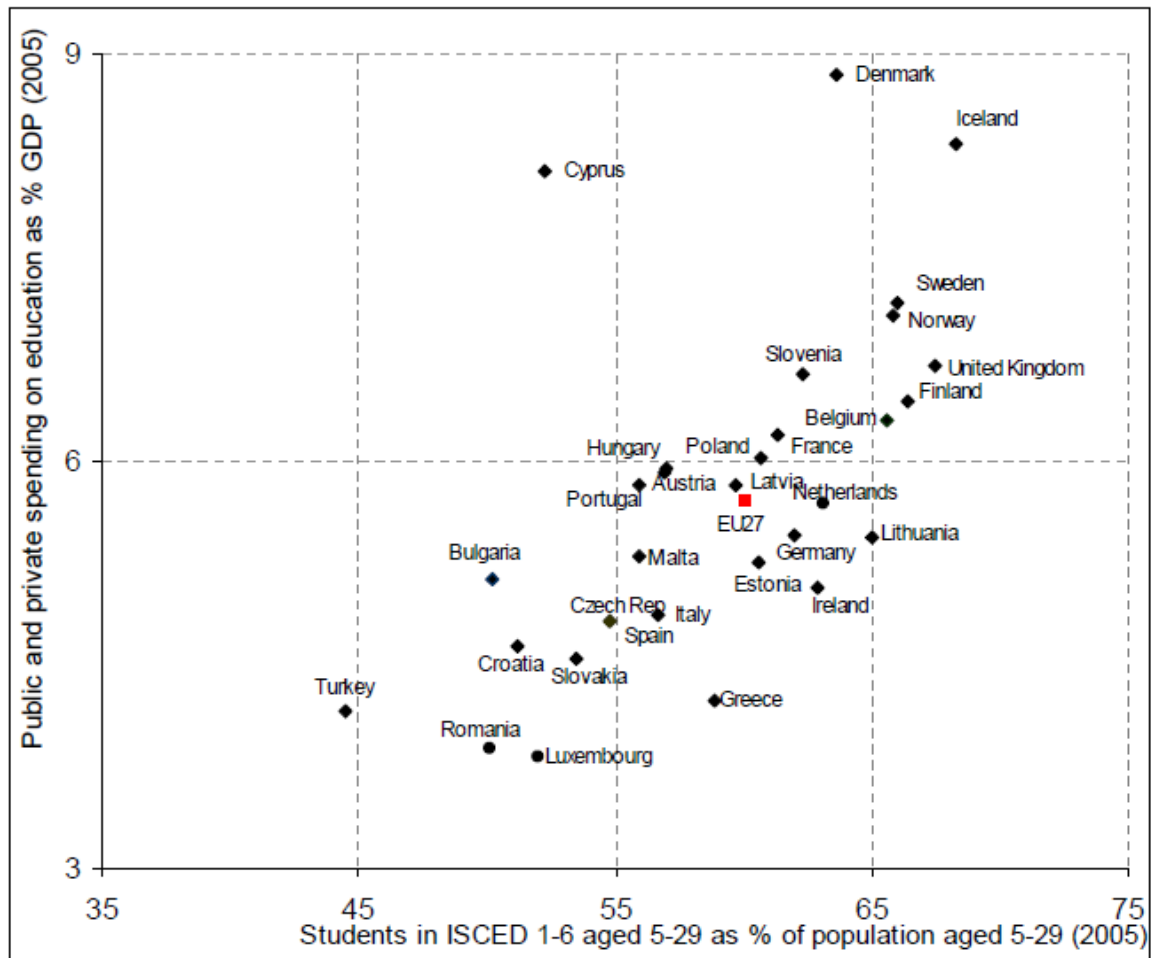
Essentially, one can talk about privatisation of higher education in two contexts:

- In terms of privatisation of funding sources, or
- In terms of privatisation of the institutions themselves

Both merit some element of discussion –

In terms of funding, it is a fact that the level of funding of Higher Education is in fact proportional to the levels of participation in the respective education systems.

Chart 8.2 Investment in education per pupil/student (Isced 1-6), 2005



Source: CRELL, Joint Research Centre.

The latest data available for the EU-27 shows an unmistakable trendline. It also seems to be system-proof in the fact that despite significantly different educational philosophies the anglo-saxon and the continental/Nordic models seem to achieve more or less the same participation rates for the same level of investment.

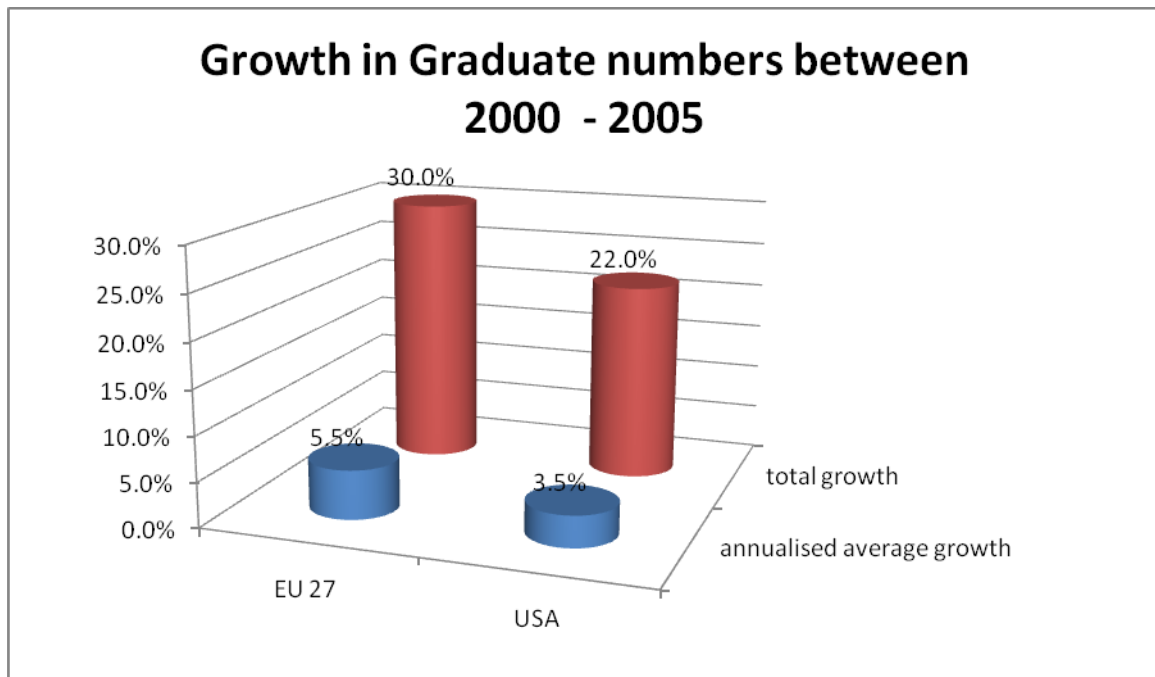
The European Commission has set a target of 2% GDP investment in Higher Education, coming from both public and private sources. At the moment, the European model of Higher Education is based primarily on public financing – in 2004, over the EU-27, direct public financing of HE was set at 0.95% of GDP,

while private payments constituted 0.35% of funding, of which 0.11% of GDP were household payments, i.e. tuition fees.

Comparatively, in the US direct public spending decreased over the period 2001-2004, representing only 0.54% of GDP with the other 1.91% of GDP coming from private payments.

It is often quoted that there the difference between the two continents shows a funding gap and that if Europe is to catch up to the US in terms of overall percentage of the population graduating this funding gap will need to be filled in the same means as it has been in the US.

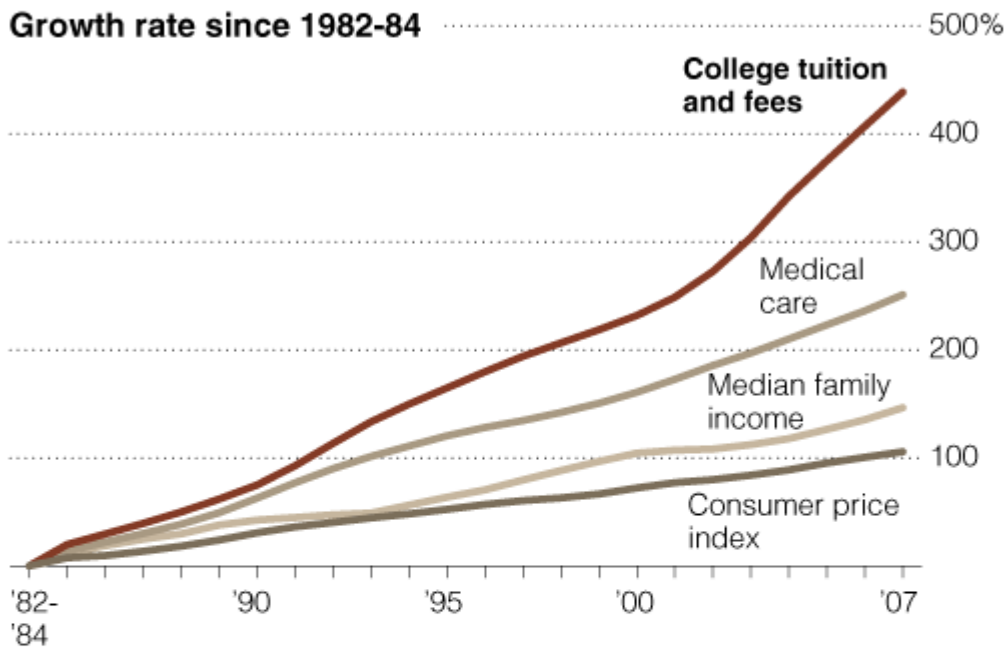
While the situation of the US with regards to participation in Higher Education is far better than that in Europe, it is useful to look at whether the policies *currently* being implemented in Europe are bearing fruit. For the period 2000 – 2005, which was the first period in which we saw the reforms of the Bologna Process and the increased focus on a knowledge based economy thanks to the Lisbon Agenda, we find that on average, the number of graduates per year in EU-27 countries grew by 5.5% year, or an annualized growth rate 60% higher than that in the US. As the effect of these policies continue to be felt in the various institutions, we are likely to see further increases in participation numbers. While the fact that the EU growth rate is higher than that in the US can be largely attributed to the fact that the EU has more scope to grow in this area, it cannot be denied that the current system of public financing coupled with reforms being triggered by the Bologna Process and the Lisbon Agenda are already causing positive and significant increases in those completing higher education – a trend, which if continued, would see Europe catching up to the US in terms of graduates within a few years.



In trying to decide whether to stay our course, and try to reach the participation targets using mainly public financing, or follow the example of the US and other countries who have followed a mainly private funded system of education, it may be useful to look at the results this had in the US. In a report published only three days ago, the US national centre for public policy and higher education compared the costs of a college education in the US over the last 25 years, and compared it with several important indicators. The figures below are corrected for inflation, while net college costs include tuition, room and board MINUS financial aid granted to students.

Soaring College Tuitions

College tuition continues to outpace median family income and the cost of medical care, food and housing.



Net college costs as a percentage of median family income*

INCOME CATEGORY	FOUR-YEAR PUBLIC		TWO-YEAR PUBLIC	
	1999-2000	2007-8	1999-2000	2007-8
Lowest	39 %	55 %	40 %	49 %
Lower-middle	23	33	22	29
Middle	18	25	15	20
Upper-middle	12	16	10	13
Highest	7	9	6	7

Note: Net college costs are tuition and room and board minus financial aid.

Source: "Measuring Up 2008," the National Center for Public Policy and Higher Education

THE NEW YORK TIMES

In the last 25 years, college tuition has risen 435%! Compare that with the median family income, which has risen only 145%. Even more worrying, are the effect the above figures have on equity in the Higher Education system. As you can see from the figures above, even after correction for the financial aid received by students, there is still a huge disparity in the costs relative to family

income even between a student coming from the lowest quintile of income earners and the second quintile, let alone between the lowest and the highest. For the lowest income earners in society, it now costs more than half the median family income to send one son or daughter to college. I remind you that these statistics are not for the ivy league private colleges like Harvard and Stanford which can cost even ten times more – these are the city public colleges.

The result of all this is that student borrowing in the US is increasing. For the 2007-2008 it reached a staggering 85 billion dollars. In a country where as already mentioned, private colleges charge vastly larger amounts of money, the reaction of public colleges to all of this, as taken in a recent survey is that students can afford to take on even more debt, and pay even more tuition fees!

Higher fees and more financial aid. Students and families will, in the view of most of the presidents, also need to be part of the equation by paying more for their education. The view of many of the presidents is that public education, at least, is still a very good value for the money, and that many families can and should be able to pay more. The presidents also believe that any increase in tuition and fees should be accompanied by an increase in financial aid, to offset the impact on those who are unable to afford the price of education.

The Iron Triangle (2006)

I will not make the argument that it is impossible to create an equitable system of higher education through private funding coupled with financial aid. However, evidence from around the world, of which I have shown you a small selection does make some points:

- The European public financing model, coupled with structural changes is leading to significant increases in participation
- A user funded / cost-sharing model is by definition inequitable unless mitigated by financial support for those who need it
- The complexity of designing such financial support systems leads to a very significant risk that inequity will nevertheless persist, as the latest statistics from the US show.

As mentioned earlier, the other aspect of privatisation of education is the privatisation of the institutions themselves. Amongst the various reasons give for privatisation, the most important are:

- Private management is more efficient than public management
- Privatisation of HE leads to competition (and hence improved quality and price)
- The private sector will by nature be more consumer oriented

Before considering each of these arguments, it helps to remember the objectives of any private sector company. By definition, these include the following three principles:

- Maintain the bottom line of the company through continued profitability
- Increase shareholder value through growth
- Improve market share through competition

These three values of maintaining the bottom line, increasing shareholder value and improving market share are universal for any company, therefore the

question in determining whether privatisation of education constitutes a good or a bad thing, involves determining whether these values are reconcilable with the core values of a higher education system and of an individual university.

With respect to governance of institutions, the essential reason for the perceived difference in effectiveness of the governance between public and private institutions is once of autonomy. In a recent report, the Bruegel think tank was able to prove using regression analysis that universities with autonomous management boards perform better on the Shanghai ranking, a potential measure for quality, than universities without autonomous management.

Thus, the question becomes which structure can best promote an autonomous governance structure, public or private? One should further note that in talking about an autonomous governance structure, one should not confuse this with self governance. Using the Bruegel definition, an autonomous university has:

- Legal standing
- Its own assets
- The capacity to contract
- The ability to hire staff and set their pay levels
- The freedom to set budgets
- The freedom to develop policies of every kind

The question of whether the shareholder of a university is the government or private investors, does not seem *per se* to affect autonomy, since while in the past it has not been customary, there is no barrier to a government awarding autonomy to a university board, much in the same way as the shareholders of a

company would award autonomy to the board of directors to act on their behalf and on behalf of the company.

Thus, like with any management structure, the main difference between the two becomes in their composition and the vested interests such composition entails. Good management practices would entail that the governing structure would include representatives of the stakeholders within the institutions such as the academic, non-academic staff and stakeholders, representatives of external stakeholders as well as some representative of the shareholders. Here lies the main difference in the two systems – in the case of the public institution, where the shareholders are essentially the government, the ‘vested interests’ are in fact the public good. The argument for a private institution is that, since it is in the ‘business’ of providing higher education, which is in itself a public service, thus, its actions are also by nature in the public good. While in many cases this might be true, depending on the policy of the board, who is tasked only to work for the public good as long as this is in line with the interests of its shareholders, there is a risk that its actions will not be in the public good. To illustrate by example, food is a public good, therefore by corollary one might assume that the free provision of bread is a public service. However, if one hands out bread to clients of a jewellery store, can it really be said to be a public good?

As for the question of competition, it is postulated that since enterprise is by nature competitive, it will improve the quality of its product to gain an edge over its competition. It should be noted that while competition can be considered a positive force overall, this is not universally the case – for example it is perfectly conceivable to imagine institutions competing on the basis of

price alone, even at the cost of quality – essentially creating a race to the bottom detrimental to all involved.

However, so as to analyse whether it is in the nature of private enterprise to compete as compared to public institutions, it is necessary to consider the incentive/disincentive structure in each scenario. Speaking in general terms, it can be successfully argued that the incentive for a business to compete is due to economic factors – in a free market environment, there is a strong economic incentive, since competition will lead to increased profits, while not competing can lead to losing market share and possible bankruptcy. Furthermore, there is an incentive to orient the offering specifically for customer demand, irrespective of the needs of society, since the essential objective of maintaining the bottom line demands ensuring happy consumers.

On the other hand, a system of lump-sum financing in Higher Education, where universities are given set amount of money irrespective of any criteria such as student numbers, research results etc, provides an opposite system of incentives and disincentives. In this case, the incentive is rather to maintain the status quo – since this is an easier more secure route with no risks – while competing for students, for research or for staff might risk alienating institutions with which an institution cooperates, and also might cause a university to actually suffer financially if it is too successful.

However, the advantages of the incentives and disincentives used in the private sector can easily be ported to the public, specifically through two measures:

- Increased funding autonomy for institutions
- Implementation of formula funding mechanisms in institutions, where a base level of funding is guaranteed, but further funding is made

dependent on performance criteria including student numbers, quality control results, and research performance.

An increasingly autonomous university also tends to develop its own brand and identity more strongly, leading to a whole new set of incentives in terms of increasing the prestige of the institution. Furthermore, such a system also ensures that the quality benefits of competition, provided they are backed up with a sensible system of quality assurance, remain intact while also ensuring some reflection of the needs of society as well as those of the individuals participating within the system.

The main advantage of a public system, is that by using a hybrid funding system, with a basic grant being guaranteed in the public interest, competition becomes a tool for improvement of current conditions, rather than one needed to ensure even survival. It also means that the number of competitors is regulated, thus ensuring that the market does not become over-saturated. Thus, the public system encourages competition, reaping its advantages, while eliminating some of the risks which truly cutthroat competition, popular in business, can bring about.

I cannot conclude this speech without making some references to a mixed model, that is a system where public institutions and private institutions stand side by side. The discussion on such a system is the merit of a speech of its own, however some points can be raised:

- In a mixed system how do you guarantee public responsibility?
 - o Can public responsibility be guaranteed solely by regulation, in terms of funding rules and quality assurance?

- How do you measure cost-efficiency of Higher Education? In choosing whether to fund public and private courses with similar quality profiles, how do you determine which one is most efficient?
- Is public provision the only way to truly guarantee continuity?
- How do we prevent parasitic mission creep?
 - Mission creep: the process of a university taking over the mission of another
 - *Parasitic* when it is targeted at particular, profit or reputation generating missions only, e.g. MBAs but no humanities
 - What does this mean for the definition of a university?
 - You are only a university if you are multi-disciplined?
 - What does this mean in terms of barriers to access for the private sector?
 - Are loss making activities part of the necessary working of a university, or have we failed to be innovative enough to exploit them?

In this short discussion, I have essentially tried to SWOT systems of public and private university provision. One thing which comes out clear is that the public sector has much to learn from the private whether it be in terms of funding, governance or competition. It is further clear that in a number of systems, public administration is not providing institutions with sufficient incentives to

modernise and keep with the times. However, the solution to these problems has already started and is continuing with positive results, in terms of both the Bologna Process and the EU's modernising agenda for higher education. While I believe no one has the right to deny a private entrepreneur the right to offer an educational service if they wish to, the solution to our problems in the Higher Education Community is not to just hand those problems on to the private sector and let them solve them for us.

To end the presentation on the same note as I started, and to echo the thoughts of Mr. Zgaga and Mr. Nyborg before me, an element of risk is part and parcel of any business deal – a fact of which we have been reminded very strongly lately. In business great success and profit is possible – but so is great loss. Our Higher Education systems form the basis not only of our economies, but of the social fabric of our communities. Thus, the question I would ask you to consider is the same question any bank manager would ask you when investing your funds, in your opinion:

Is the risk worth it?

Thank you.