Submission on

A FUTURE TERTIARY EDUCATION

POLICY FOR NEW ZEALAND:

Tertiary Education review

NEW ZEALAND BUSINESS ROUNDTABLE

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CONTENTS

EXECUTIVE SUMMARY

- The review of tertiary education provides an opportunity to advance policy affecting an important sector of the economy.

- The government should only intervene where the benefits from doing so exceed the costs. A case for intervention must be made that, in its absence, people will fail to invest in optimal kinds, qualities and quantities of human capital and will not undertake on-job and off-job education and training efficiently.

- The government's policy objectives for tertiary education that are contained in the Green Paper are unrelated to its role in the economy and they are unduly narrow.

- Efficiency and equity arguments for large subsidies for tuition and research are weak.

- The discussion presented in the Green Paper implicitly recognises that it is not credible that the external benefits that arise from tertiary education can justify the current level of subsidy.

- The observed behaviour of students suggests that private, rather than external, benefits are the primary motivating factor in the choices they make.

- External benefits in education are reflected in the willingness of alumni and private benefactors to endow scholarships and institutions. A case would need to be made that government interventions here would do more good than harm.

- The externality argument for government tuition subsidies is inconsistent with the failure to claim back assistance from former students who migrate, the absence of subsidies for immigrants who are graduates and for students who study abroad, and lower subsidies for students at private training establishments compared with those enrolled at state-owned institutions.

- In the view of the New Zealand Business Roundtable (NZBR), it is most unlikely that any additional external benefits that accrue over those which would be funded in the absence of any government subsidy to tertiary education would be sufficient to justify the present level of subsidies.

- Some research may be an essential part of the teaching process. Students will be willing to pay for such research through their fees. Competition among providers would lead to efficient combinations of teaching and research.

- If the government wishes to encourage research that generates non-excludable benefits, then funds should be allocated for the purpose on a contestable basis. There are no grounds for directing such funds to domestic tertiary institutions alone or for penalising them relative to other providers.

- To the extent that capital market impediments justify government action, unsubsidised loan schemes, including loan guarantees, may be appropriate.

- Government subsidies to tertiary education are not easily justified on equity grounds. People who have the intellectual ability and other attributes necessary to succeed in tertiary education are likely to be advantaged relative to other members of the community. The subsidies that they enjoy accentuate income differentials over their lives.

- Even subsidies targeted at disadvantaged students are a poor instrument for infuencing the distribution of income because many people from disadvantaged backgrounds do not go on to higher education.

- If the government were committed to promoting participation by groups that are less than proportionately represented in tertiary education it would focus on targeting assistance, such as scholarships, to the identified groups rather than providing universal assistance.

- In a 1988 report prepared for the NZBR, Professor Richard Blandy suggested that scholarships, loans and loan guarantees equal to, say, 30 percent of fees be provided for students who maintain good standing. The NZBR is not aware of any subsequent research which suggests that there are valid public policy grounds for a higher level of subsidy.

- The forthcoming White Paper should present the case for lower effective subsidies (that is, taking account of subsidised tuition, living costs and loans) and outline a programme to reduce them to, say, 30 percent of tuition costs over the next ten years. A further review should then take place.

- The argument for lower subsidies is based on equity and efficiency principles and is independent of the level of participation in the tertiary sector.

- An increase in the level of private contributions would reduce government expenditure for a given level of participation. Resources freed should be used primarily to reduce government debt (future taxes) or the current tax burden. Investment in human capital would be encouraged by lower taxes, including expected future taxes.

- There is growing evidence from a wide range of countries that regulatory reform is highly profitable for society. There is every reason to expect that a less prescriptive regulatory environment for the provision of tertiary education in New Zealand would produce substantial net benefits.

- Competition in the supply of education and training is the key to enhancing the efficiency of providers. It is severely impeded by inappropriate government policy relating to entry and exit barriers, accreditation, public funding and state ownership.

- The proposal to adopt a minimum quality standard that is to be consistent with international standards is ill-conceived. A diversity of standards is much more likely to serve the interests of consumers who seek value for money not quality regardless of cost. There is no clearly defined international standard for tertiary education, and the objective of strengthening the international credibility of all New Zealand's providers is dubious.

- The proposed quality standard contained in Appendix C of the Green Paper illustrates that central agencies are poorly placed to judge such matters objectively and thoroughly.

- Tertiary funding is substantially biased in favour of state providers and impedes competition. The government should adopt a planned programme to phase in neutral funding by the academic year that commences in 2002.

- One consequence of moving toward neutral funding is that it will require the government to identify clearly the public good element of courses and programmes which it considers to be a justification for public funding. This discipline would be similar to that imposed by the government on local authorities to identify the public good component of their services in determining their charging polices.

- Because of their size and significance, state institutions will dominate the provision of formal tertiary education and training in the medium term.

- State providers currently face inadequate incentives to improve their efficiency.

- The government should move to establish state institutions as either private for-profit or not-for-profit organisations.

- The coalition agreement stated that the government is to undertake a comprehensive review of all aspects of the tertiary sector. The present review falls well short of fulfilling that commitment.

- It would be a mistake to produce the proposed White Paper or papers without a thorough reexamination of the issues that should be addressed. A process that brings greater rigor and breadth to the review is required. We propose that an independent committee of experts be established to review the Green Paper and submissions and report to the minister of education.

- Our recommendations are presented in section 4.

1 OVERVIEW

This submission is by the New Zealand Business Roundtable (NZBR). It has been prepared in response to the government's request for comment on its Green Paper, *A Future Tertiary Education Policy for New Zealand: Tertiary Education Review* (the Green Paper).[1]

The NZBR is an organisation of chief executives of some of New Zealand's largest businesses. Its purpose is to contribute to the overall development of New Zealand and to promote the interests of all New Zealanders concerned with achieving a more prosperous economy and fair society. We support policies that advance the interests of the wider community rather than sectional interests. Our submission has been prepared from this perspective.

The economic reforms that have been implemented since 1984 are shaping a more competitive and dynamic economy that is better able to satisfy the economic and social aspirations of all New Zealanders. Despite the progress that has been made, the task of reforming the economy is incomplete. Unemployment remains a serious problem, government expenditure is excessive and many sectors of the economy, especially those that are largely protected from international competition like education, are performing poorly. There are widespread concerns within the community about the quality of education at all levels. Inappropriate government policies are a major cause of the shortcomings.

The achievement of a high income economy and the attainment of other social goals requires extensive investment in human capital, not just prior to entry into the work force but on an ongoing basis. Nobel Laureate Gary Becker (1993) has written that:

> Human capital is important because productivity in a modern economy is based on the creation, dissemination, and utilisation of knowledge.

Professor Becker speculated that investment in human capital, broadly defined to include the knowledge and skills embodied in people, their health and the quality of their work habits, accounts for over 20 percent of the GDP of the United States. A broadly similar order of magnitude might apply in New Zealand. Professor Becker also suggested that the amount spent on on-job training in modern economies may be as large, perhaps even larger, than that allocated to formal schooling. For this

1 Cited in the bibliography as Creech (1997).

reason, a broad view of education and training rather than a focus on formal tertiary education, which is largely provided by state entities, is required.

Sub-optimal investment in human capital development – too little, too much or inappropriate kinds of education and inefficient provision of education – has the capacity to constrain economic and social performance. This also applies to other classes of investment. Because education is not distinctive or special it should generally be treated on the same basis as other classes of investment. Consumers, for example, can be expected to assess the quality and cost of tertiary education against its benefits. While reliable assessments are difficult to make, they are unlikely to be more difficult than judging the return from investment in many other activities.

The effectiveness of spending on human and other capital, and the kind of work habits and attitudes that are developed, depend heavily on the incentives provided. The key role of the government is to provide a regulatory framework which will encourage people to invest in optimal kinds, qualities and quantities of human capital and which will encourage on-job and off-job education and training to be provided efficiently. In this way the tertiary education sector can make the best possible contribution to the advancement of community welfare.

Although the Green Paper correctly aims to increase the responsiveness, innovation and adaptability of providers of tertiary education, it fails to address the inherent conflict between the attainment of that goal and the central planning approach and heavy reliance on subsidies and state ownership which dominate the sector. There is a need to foster competition and to adopt funding and ownership arrangements which are compatible with decentralised decision making.

A market-based system would allow students to choose among competing providers. It overcomes the information problem that arises with central planning because price signals convey information to producers on the value students place on different educational opportunities and provide the incentive for producers to respond to their preferences. Competition would be enhanced by better regulatory arrangements and by addressing the ownership of state tertiary institutions on a first principles basis. If New Zealand education institutions continue to be hamstrung by inappropriate regulation and ownership structures, they will be poorly placed to face competition from abroad and to adapt to technological change.

The government's policy objectives for tertiary education contained in the Green Paper are inappropriate. The first two objectives are to increase participation in tertiary education, particularly by groups that are less than proportionately represented at present. The assumption is that many students who choose not to participate in tertiary education are making the wrong decision from a community perspective. Yet no information has been produced on why Maori and Pacific Island people are regarded as particularly likely to make incorrect decisions. The intention to increase participation is inconsistent with the view, expressed in the Green Paper, that choices are best left to individual students. Moreover, the policies proposed in the Paper are not well designed to maximise participation. Better policies could, for instance, entail subsidies targeted at students who would not otherwise attend and might call for measures aimed at correcting poor performance by schools.

The discussion on the level of per student funding contained in the Green Paper appears to be evasive and timid. It hints at lower subsidies as participation rates rise. Efficiency and equity arguments do not support large and untargeted subsidies to tertiary education and there are no valid public policy grounds to lower subsidies for the marginal student as participation increases.

Many countries have lowered their subsidies for tertiary education or are planning to do so. *The Economist* (1997) reported that most students in Japan, South Korea and Taiwan attend private universities and pay the full costs of their studies. Private universities in the United States, which are among the most highly regarded in the world, charge relatively high fees. Britain is to abandon its policy of not charging fees and Australia has increased the level of its fees for new undergraduate students to an effective average of 30 to 35 percent of operating costs.[2] From 1998 Australian universities will be able to charge full fees to 25 percent of domestic undergraduate students who are unable to obtain a subsidised place (Industry Commission, 1997).

While New Zealand universities have persistently opposed fee increases, some have been willing to apply charges that must be close to full costs for certain mid-career courses aimed at business people. Their actions suggest that they accept that public benefits differ among courses and, for some activities, are at most negligible. A funding policy which clearly distributes any subsidies in a manner consistent with the public policy grounds on which they are justified is required.

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2 The percentages cited relate to undergraduate study and take account of the discount for up-front fees and deferred payment arrangements. Before making these adjustments, students contribute 45 percent of the (operating) costs of tuition (West *et al.* 1997).

The policies required to encourage appropriate investment in tertiary education include:

- a stable macroeconomic environment which fosters certainty and facilitates investment, including long-term investment;

- an efficient labour market which provides strong incentives for people to develop desirable work habits and to acquire education and training;

- an open immigration policy which facilitates the introduction of new skills and promotes innovation;

- a low level of government expenditure and taxes, the avoidance of excessive regulation and a carefully designed welfare system. These are necessary to limit perverse incentives which impair work habits and discourage investment in human capital;

- a reduction in the level of subsidises for tertiary education and a review of the type of activities which are assisted so that any subsidies that are provided are justified on valid public policy grounds. This would eliminate the bias toward off-job education and training, improve the effectiveness of spending on formal education and training and reduce the tax burden;

- a reduction in barriers to entry into, and exit from, the education industry which would improve the efficiency of the provision of education;

- the adoption of private ownership arrangements; and

- the removal of preferential treatment for any state entities that are retained and the introduction of governance arrangements which would facilitate more effective decision making and improve their performance substantially.

The coalition agreement stated that the government is to undertake a comprehensive review of all aspects of the tertiary sector. The present review falls well short of fulfilling that commitment. The review should provide an opportunity to advance policy affecting an important sector of the economy.

However, a more comprehensive, searching and ambitious review than that reflected in the Green Paper is required. In particular, a clear framework for analysis which is consistent with approaches taken to other sectors should be adopted. The government's funding, regulatory and ownership roles should be examined rigorously.

The Green Paper on tertiary education is one of three recently prepared for the government by the ministry of education. They highlight weaknesses in the ministry's advisory capability. In our view, it would be a mistake to pass the Green Paper on tertiary education through the ministry's bleacher to produce the proposed White Paper or papers without a thorough reexamination of the issues that should be addressed. The officials who worked on the Green Paper on tertiary education will presumably sit in judgment on criticisms of their input. An independent process that brings greater rigour and breadth to the review is required. We therefore propose that a committee of experts be established to review the Green Paper and submissions and report to the minister of education.

This submission is presented in 4 sections. The next section (section 2) discusses possible grounds for subsidising tertiary education. Regulatory issues are discussed in section 3. Our recommendations are presented in section 4. The Annex to this submission contains brief comments on the proposals contained in the Green Paper. It is to be read in the context of the broader arguments advanced in the body of the submission.

2 POSSIBLE GROUNDS FOR SUBSIDISING TERTIARY EDUCATION

2.1 Public Goods

Economic theory recognises that there is a category of goods or services, called public goods, that may not be efficiently produced in private markets and therefore give rise to a *prima facie* case for government intervention. The criteria which distinguish public goods from private goods have been carefully defined. Pure public goods have two characteristics. First, they are non-excludable in consumption, which implies that it is not feasible to prevent anyone from consuming the good or service once it has been produced. Secondly, pure public goods are non-rival in consumption. Once the good or service has been provided an additional consumer can benefit from it without imposing any costs on existing consumers.

Tertiary tuition clearly fails to satisfy both criteria. Potential students are able to be excluded from courses and the addition of extra students imposes incremental costs on providers. The latter is illustrated by complaints from providers that are required to bear the costs of educating so-called under-funded students.

2.2 External benefits and costs

The presence of external benefits is the main ground that has been advanced for government subsidisation of tertiary education. In this context an externality refers to any benefit that is derived by individuals or organisations that are not directly involved in such education and is not paid for by them. From the community's point of view, leaving the production of externalities to the market may result in a misallocation of resources because decisions affecting the level of production reflect private rather than social benefits and costs.

Several commentators have argued that tertiary education (especially formal education) produces substantial external benefits that would not be obtained unless subsidies were provided. Those mounting arguments on these grounds tend to list a variety of external benefits supposedly generated by tertiary education and training.[3] As noted by the Ministerial Consultative Group (MCG), it is one

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[3] See, for example, Devlin *et al.* (1994). The Industry Commission (1997) provides a list of external benefits that was drawn from selected literature.

thing to observe external benefits and another to demonstrate a case for a subsidy.[4] It is not sufficient merely to list external benefits.[5]

Brennan (1971) and Fane (1984) correctly argue that it is the *extra* public benefits that might be generated by subsidies, rather than their absolute amount, which is relevant. Hence there are no grounds for subsidising students to learn to read, write and do basic arithmetic, and thus be able to participate in society, if students would generally undertake such education in the absence of assistance.[6]

Possible external costs also need to be taken into account. The risk of over-investment in certain forms of tertiary education and training may be as serious as that of under-investment. Research indicates that education may, in part, be a sorting or screening mechanism (Arrow, 1973). Education may serve to identify people who are advantaged through ability and who are likely to be more productive.[7] Entry into some occupations may be unjustifiably restricted to people who hold certain education qualifications, thereby imposing external costs on consumers. Resources invested in education and training may not yield a return in terms of better citizens or more productive workers. Other external costs of education may include civil disobedience and disharmony (Friedman and Friedman, 1990). Universities in particular have been the source of many socially damaging ideas. For example, with few exceptions, staff employed by New Zealand universities opposed recent reforms such as tariff reductions despite their overwhelming support in the economic literature.

New (endogenous) growth theory suggests that investment in human capital is an important source of economic growth. According to the theory, growth is a function of the marginal productivity of capital which is broadly defined. However, empirical evidence of such external benefits remains elusive. The theory does not tell us what type of human capital investment produces growth externalities. It is a

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4 The Ministerial Consultative Group is cited in the bibliography as Todd *et al.* (1994).

5 A careful examination of the attributes of tertiary education narrows the range of potential externalities. Many of the benefits identified are derived by the graduate, such as non-pecuniary rewards in terms of status and recognition, or are captured in the form of improved incomes.

6 For the same reason, the government does not need to subsidise people with mobile telephones who advise emergency services of accidents or crimes.

7 This is illustrated by an apparent increase in credentials required to enter various careers. The prerequisite for entry into careers has increased over recent years. Examples are primary school teaching, where three-year courses have replaced two-year ones, and nursing where polytechnic courses have replaced on-job training. It is doubtful whether a longer period of full-time training has, in all cases, resulted in commensurate increases in the productivity of graduates. The additional qualifications and length of training may serve, in part, as a sorting mechanism which enables students to demonstrate their ability.

large step to claim that formal tertiary education and not on-job training leads to growth. Furthermore, Sieper (1997) is scathing of the development in theorising that led to new growth theory.[8]

Externalities occur throughout the economy but most do not justify government action. Given the level of education that individuals would privately choose to undertake if there were no government subsidy, the relevant issue, ignored by many New Zealand commentators, is:

- whether further increases in tertiary education would generate any significant *additional* externalities; and

- whether the value of additional externalities exceeds the costs of government action, including the deadweight costs of raising revenue to fund subsidies.

These are demanding criteria, given that the deadweight costs of tax levied on consumption and labour income in New Zealand are at least 14 and 18 cents for the last dollar raised (Diewert and Lawrence, 1994). The marginal cost of the taxation of capital income is likely to be even higher and administration and compliance costs of 8 cents also need to be taken into account. Thus the current tax system imposes deadweight losses of around 30 cents for the last dollar of revenue raised. To produce a net gain in efficiency, therefore, $1 of marginal government spending has to deliver a benefit of at least $1.30.

If tertiary education provided mostly public benefits, and private rates of return were as low as some people claim, students would have little reason to undertake tertiary studies or to care about the courses that they take. The observed behaviour of students and providers, such as competition to gain entry into medical schools and advertising aimed at attracting students, suggests that private, rather than public, benefits are the primary motivating factor in the choices that students make (Fane, 1984). Maani (1997) observed that:

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8 Sieper (1997) commented that "Those unfamiliar with modern growth theory, and therefore unaccustomed to thinking of labour (entirely) as capital, may wish to reflect that whereas the classical economists ... worked with three factors (land, labour and capital) the post-war neoclassical growth theorists ... felt able to dispense with land, leaving only labour and capital, together with technical progress (about which the classical economists had their doubts). Modern "endogenous ... growth" theorists have gone one better by disposing also of labour and have then ... needed to join their classical forebears in ignoring technical progress. At this rate it would seem more than likely that the intellectual development of the subject will shortly be complete."

> A host of international studies have shown that [private] returns to education are positive and significant ... .

Her study for New Zealand showed that private returns to tertiary education are attractive, that they increased between 1981 and 1991, and are comparable to those of other high income countries.[9]

Private rate of return analysis should not, however, determine appropriate levels of subsidy. Subsidies reduce the investment required by the student and therefore increase his or her return. Private returns can be expected to fall in due course because the higher initial return will eventually increase the supply of graduates. Low private rates of return for some graduates may merely indicate over-investment in particular forms of tertiary education and training which could be addressed by reducing subsidies. They may also reflect excessive costs of education, such as unduly long courses, an unnecessarily short academic year, and the failure of providers to innovate.

There is little evidence to support the view that net external benefits generated by tertiary education are substantial and warrant large public subsidies. As Blaug (1972) reported:

> The idea that the external ... benefits of education to society as a whole are enormous in magnitude and vastly exceed the direct personal benefits to "educatees" is one of the myths of our times ... because there is virtually no evidence of any kind to support it.

In similar vein Fane (1984) reported that:

> Our own best guess is that the relevant marginal net external benefits of education are very small, so that from the perspective of efficiency the optimal subsidy is probably close to zero.

The Economist (1997) summarised the position in the following terms:

> Some of the benefits of higher education plainly flow to society as a whole, not only to the individual graduate. But it is far from clear whether this justifies a public subsidy, and if so, how much.

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9 An alternative view is presented by Stephens (1996). Stephens's analysis suggests that private rates of return vary substantially among different classes of New Zealand graduates and are often low.

Even if the external benefits from tertiary education were significant, they are likely to differ among courses. Marginal benefits are also likely to diminish as the length of tertiary study increases, such as study for conjoint degrees. Furthermore, the externality argument for tuition subsidies is inconsistent with the failure to claim back assistance from former students who migrate on, or soon after, graduation, the absence of subsidies for immigrants who are graduates and for students who study abroad, and lower subsidies for students at private training establishments compared with those enrolled at state-owned institutions. In summary, the external benefit argument could not plausibly justify the present level and pattern of subsidies to tertiary education.

One way of testing whether people actually believe that significant externalities are generated by tertiary education would be to consider altering the way in which subsidies are paid, but not their amount in present value terms. Subsidies would be paid to graduates of tertiary institutions on an annual basis after they enter the workforce and as the external benefits from their education are derived.[10] Assistance that is designed to produce socially desirable levels of service would, where feasible, be paid on an output basis as affected services are rendered rather than on inputs. If presented with this proposition, it is unlikely that the provision of substantial subsidies to graduates would find widespread support among taxpayers.

The discussion presented in the Green Paper implicitly recognises that it is most unlikely that any additional external benefits that arise from tertiary education would justify the current level of subsidy. It observes that OECD governments have been unable to establish a consistent rationale for their present level of subsidy for tertiary education and notes the MCG came to a similar conclusion in respect of New Zealand. The Green Paper correctly records that "the overall contribution [to tertiary education] by the government of the day should relate to the public benefits from tertiary education" but it fails to confront the consequences of this view for the level of subsidy to be provided over the next two decades. The logical conclusion of the above argument and that contained in the Green Paper is that a substantial reduction in tuition subsidies is required on efficiency grounds.

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10 The Industry Commission (1977) suggests that the annual payment to each graduate of between A$600 and A$3,300 a year is implied by Australia's present level of subsidy of tertiary education.

2.3 Possible efficiency grounds for subsidising research

The returns from much research are captured by the investors involved because patent and other arrangements are designed to protect the property rights of researchers. Some research may, however, produce large benefits which are non-excludable and producers may not find it profitable to undertake projects that would be worthwhile from a community-wide perspective. The question then is whether the benefits of government intervention outweigh the costs involved.

If the government wishes to encourage research that generates non-excludable benefits, then funds should be allocated for the purpose on a contestable basis, and the research output monitored and researchers rewarded through a performance-based mechanism. There are no valid grounds for directing such funds to tertiary institutions alone or for penalising them relative to other entities. The Public Goods Science Fund broadly reflects this approach, although it is apparent that at least some research that is supported by it largely generates private benefits.

Some research may be an essential part of the teaching process. It may benefit students by improving the quality of teaching or enhancing the reputation of the tertiary institution. Students will be willing to pay for such research through their fees. A government subsidy is not needed to encourage the production of a socially optimal amount of this kind of research. Moreover, competition among providers, rather than government regulation, would lead to efficient combinations of teaching and research.

If teaching benefits research, then institutions that teach should have an advantage in competing for contestable research funding. Whether specialist organisations are more effective providers of research output may differ by discipline and project. The direct funding of research leads to a concentration of research funding.[11] In Australia and the United Kingdom, a small number of the universities receive a disproportionate share of research funding. Research productivity varies greatly across academics. Any funding should be directed to those researchers who are the most productive.

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11 See Hare and Wyatt (1992).

2.4 Possible efficiency grounds for the provision of loans

Capital market failure is the ground cited for government action aimed at facilitating the financing of education and training. Becker (1964) wrote:

> Economists have long emphasized that it is difficult to borrow funds to invest in human capital because such capital cannot be offered as collateral, and courts have frowned on contracts which even indirectly suggest involuntary servitude.

The inability to insure against a poor return on investment in education, including the limited scope to diversify investment in education and the risk associated with investment in it, are said to contribute to this problem.

The following implications of capital market impediments were noted by Becker (1964):

- since large expenditures would be more difficult to finance than other outlays, a college education would be affected to a greater extent than certain other classes of human capital investment;

- education would commonly be financed within families. Consequently, wealthy families would tend to invest more in education than poor families; and

- since employees' specific skills are reflected in the value of firms, capital would be more readily raised by firms to finance specific education rather than general education.

There is the possibility that educational institutions might offer loans to students. They may have a comparative advantage in assessing the likelihood of students succeeding in their courses because of access to better information. There is, however, only one example in the United States of such a source of finance that we are aware of, and in that case a more generous government scheme appears to have overtaken it.

While the absence of collateral is an important constraint in many cases, there are circumstances where people raise finance based at least in part on their human capital. Professional sports people and members of the professions whose borrowing is dependent on their capacity to earn income are examples. In addition, New Zealand financial institutions have shown a willingness to lend small amounts on an unsecured basis to tertiary students.

The problem of financing education is accentuated by the age and experience of borrowers. Because most people attending tertiary education are unlikely to have had an opportunity to establish a reputation, their ability to borrow is likely to be constrained. A similar problem arises, however, if a young person wishes to borrow to start or buy a business. A school leaver from a farming family would, for instance, face difficulty in borrowing to establish a sharemilking operation without parental support.

Investment is risky because the return that will be earned in the future is uncertain. The riskiness of investment is not normally recognised as a valid ground for government action. The private sector funds some of the most risky investment undertaken such as mineral exploration and the development and marketing of new products. Similarly, various contingencies may not be able to be insured because the costs of controlling the actions of the insured once insurance has been bought (moral hazard) or the costs of identifying risks (adverse selection) are too high. The absence of insurance in the market may simply mean that self-insurance is more efficient (Demsetz, 1969). Similarly the absence of private finance may mean that self-finance is more efficient.

While capital market impediments are commonly advanced as a valid ground for government action, this view has been questioned by some economists. Fane (1984) commented that:

> Those who refer to capital market imperfections seldom describe them, and almost never analyse them, so it is hard to be sure what they have in mind.

After examining in some detail two classes of imperfections – the inability to spread risk and default risk – Fane concluded that government action was not warranted. He recommended that:

> The government should leave students to negotiate their own loans in the open market, or to finance their education by studying part-time and working part-time.

Tertiary studies were commonly financed through part-time work prior to the 1960s.

Milton Friedman was one of the first contemporary economists to note that capital market failure may impede training for the professions and to propose an income contingent loan scheme (Friedman and Kuznets, 1954). Not surprisingly, Friedman and Friedman (1990) concluded on equity (not efficiency) grounds that:

> There is a strong case for providing loan funds sufficient to assure opportunity to [higher education for] all ... There is no case for subsidizing persons who get higher education at the expense of those who do not.

To the extent that capital market impediments justify government action, unsubsidised loan schemes, including loan guarantees, may be appropriate. This follows from the proposition that the absence of reputation and collateral rather than the cost of finance are the main problems that the government may need to address.

The student loans scheme effectively provides free insurance against the risk of a low income for investors in tertiary education. The taxpayer funds loans that are not repaid and interest that is written off under the scheme. This type of financial assistance is not provided for any other private investment. There is little overseas evidence to suggest that aversion to debt discourages students from enrolling in tertiary education.[12] It is in the self interest of students to criticise the loan scheme and to express a preference for lower fees and higher universal allowances.

The subsidies provided via student allowances and the loan scheme, which are not examined in the Green Paper, cannot be justified on the grounds of capital market failure. The proponents of the MCG's option B recommended that the generosity of the loan scheme be reduced. They proposed the adoption of a market rate of interest, a limit on the period of study for which loans would be available, the accrual of interest in certain circumstances, the introduction of a higher rate of repayment for people on relatively high incomes and an increase in the income threshold.

The subsidies provided by the loan scheme are substantial. They should be phased out. This would require the adoption of a market rate of interest, the accrual of interest and the introduction of a fee for the actuarial cost of the insurance element embedded in the present scheme.

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12 Overseas research cited in the MCG report indicated that students from higher income backgrounds, who predominate in tertiary education in other countries as well as New Zealand, are relatively insensitive to debt and to fee levels. Tertiary enrolments increased at the same time as the income contingent loan scheme was introduced in 1992, suggesting that other factors, such as private rates of return to education, were more important.

2.5 Possible equity grounds for tuition subsidies

Fane (1984) observed that the most frequently cited explanation for government involvement in the education system relates to the advancement of equity objectives. They are usually loosely defined. The desire to encourage participation in tertiary education by people from groups that are less than proportionately represented is a goal noted in the Green Paper. This appears, however, to be a means to an ill-defined end. The apparent concern may be that if access to tertiary education is restricted to people from certain socioeconomic groups, income differences due to education will be transmitted from one generation to the next (Blyth *et al.,* 1987). The underlying objective appears to be to achieve a more uniform distribution of income than otherwise.

There are several grounds for concluding that subsidies to tertiary education are not justified on such grounds:

- people who have the intellectual ability and other attributes necessary to succeed in tertiary education are likely to be advantaged relative to other members of the community. Not only are they likely to enjoy higher lifetime incomes but they enjoy other advantages associated with intellectual and cultural capital as well. This view was forcefully put by Alchian (1977) who observed that:

  > Subsidised higher education ... grants the college student a second windfall – a subsidy to exploit his initial windfall inheritance of talent. This is equivalent to subsidising the drilling costs of owners of oil-bearing lands in Texas.

- tertiary students tend to move from low incomes whilst studying to relatively high incomes after graduation. Thus the subsidies that they enjoy accentuate income differentials over their lives; and

- there are better ways of assisting people with low incomes. Because many disadvantaged students do not go on to higher education, subsidies for tertiary education are a poor instrument for influencing the distribution of income.

While the NZBR agrees that the government should provide safety net assistance for people who cannot support themselves and cannot be helped in other ways, it does not agree with policies aimed at equalising incomes.

Some of the most robust findings of the MCG related to the distribution of the benefits of tuition subsidies. Broadly, these conclusions, which are as valid today as they were in 1994, were that:

- students from higher income backgrounds are more than proportionally represented in formal tertiary education, even after life-cycle effects are taken into account. Formal tertiary education attracts the greatest proportion of subsidies. Subsidies therefore disproportionately benefit people from higher income backgrounds;

- accentuating the previous point, people who undertake tertiary education and training courses that attract the highest levels of subsidy generally come from the highest income backgrounds and subsequently earn higher incomes than other people in their cohort; and

- participation in tertiary education and training is correlated with ethnic status. Maori, for example, have lower than average rates of participation in formal tertiary education courses that attract the lion's share of subsidies. On the other hand, they are more than proportionally represented in the training opportunities programme (TOP).

The Watts review of New Zealand universities (Watts *et al.,* 1987) reported that:

> ... the most common observation in the international literature on accessibility to higher education is that financial conditions are not a significant barrier for the great majority of potential students ... . The international literature suggests that perceptions of the value of university education are among the most important factors. In this respect, the level of parents' education and peer group influence seem to be the strongest influences on a student's decision whether to continue to university education.

The literature does not support the view that a reduction in tertiary subsidies would increase educational inequalities. D Bruce Johnstone, then President of Buffalo State College in New York, undertook a study on student financial assistance in the United Kingdom, the Federal Republic of Germany, France, Sweden and the United States (Johnstone, 1986). His conclusion was that:

> The evidence is overwhelming, in centrally planned as well as in market-oriented countries, that free tuition and generous maintenance grants are insufficient in themselves to achieve socioeconomic, ethnic, or regional distributions within the student population that mirror those distributions in the general population ... higher grants to under-represented students, coupled with reduced subsidies to over-represented students, could achieve a more nearly equal distribution of student places.

The merits of spending aimed at promoting participation by groups that are less than proportionately represented in tertiary education are unproven. Moreover, if the government were committed to implementing such a policy, as implied by the goals contained in the Green Paper, it would focus on targeting assistance, such as scholarships, to the identified groups rather than universal assistance.

We do not believe, however, that such assistance is justified. The student loans scheme provides people with an opportunity to finance tertiary studies in circumstances where access to finance, including intra-family support, might not otherwise be available. As noted, tertiary students are generally advantaged by their ability and will later typically earn higher than average incomes.

2.6 Other possible grounds for subsidies

2.6.1 Merit goods

Education is sometimes referred to in the literature as a merit want, good or service. Musgrave (1959) introduced the concept of merit wants.[13] He argued that goods and services that are capable of being supplied privately may be considered so meritorious that they are subsidised by the government. Publicly provided school lunches, low cost housing and free education were cited as examples of merit wants. This is essentially an equity argument for the subsidisation of education.

Interference with individual preferences (consumer sovereignty) constitutes the essence of merit wants (Head, 1990). Musgrave (1959) discussed whether merit wants should have a place in economic policy, given the importance of individual preferences in a democratic society. According to Musgrave consumer sovereignty rests on the assumption of complete market knowledge and rational appraisal. In his view, incomplete knowledge and irrational evaluations by individuals may lead to distortions in individual preferences that need to be corrected. Musgrave acknowledged that the satisfaction of merit wants "remains a precarious task." Interferences with consumer choice may occur simply because a ruling group considers its particular set of mores superior and wishes to impose them on others.

In a review of the concept of merit goods, Musgrave (1990) confirmed that the concept questioned the premise of consumer sovereignty. Musgrave also noted that constraints on consumer sovereignty that arise in the case of the young and mentally deficient are "not part of the essential merit good problem." Similarly, he stated that factors such as imperfect or misleading information, myopia, and misjudgments do not give rise to a case for merit goods. Musgrave concluded that no unique definition of the merit good concept emerged from his survey. Head (1990) expressed reservations about Musgrave's concept of merit wants which remains controversial.

Jonathan Boston of the Victoria University of Wellington submitted to the MCG that it may be justifiable in some situations for society to override, constrain or shape individual preferences because:

- they may be based on inaccurate or inadequate information;

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13 Head (1990) notes that Musgrave has restated his merit wants concept on numerous occasions, often with significant variations. For a discussion of merit wants see Brennan and Walsh (1990).

- they may be poorly informed;
- they may be morally objectionable; or
- the individual in question may be too young or too ill to make a fully rational or mature decision.

Professor Boston argued that "tertiary education is important for an individual's well-being and the well-being of society, and in my view this justifies government programmes designed to encourage people to pursue tertiary studies."

This argument reflects Musgrave's early view of the merit good concept and fails to reflect a contemporary analysis of information and agency problems. Professor Boston correctly noted that critics of the concept of a merit good, of which the NZBR is one, regard it as paternalistic and morally objectionable.

2.6.2 Graduates pay higher taxes

Fraser Jackson (1993) argued that those who benefit from tertiary education pay for their education through higher taxes. He wrote:

> From the perspective of the income earner, a taxation-based system of paying for education means that the benefits are received early in life, and as the resulting benefits generate income the level of repayments increases. In a sense it can be regarded as a contract in which a proportion of all the benefits of the increased educational investment are paid in (future) taxation.

As the MCG observed, unless there is a direct link between repayments and the cost of tertiary education, taxpayers who do not participate in tertiary education bear the cost of such education. A graduate and a non-graduate earning the same income will pay the same tax, other things being equal.

In an analogous situation, Schultz noted that inefficiencies and inequities caused by the subsidisation of US farmers cannot be remedied by increasing the progressivity of the tax system.[14]

The social return to tertiary education is usually estimated on a pre-tax basis, taking account of the resource cost of tuition while omitting externalities because of the difficulty of quantifying them. The private return reflects the after-tax income of graduates and takes account of tuition fees. The estimated social return is usually lower than the private return, implying that the extra taxes paid by graduates do not cover the government subsidy to higher education.

Investment in tertiary education is favoured under present income tax rules as it is largely taxed on a consumption tax basis. Under an income tax the initial outlay is funded from tax-paid income (i.e. a tax deduction is not provided and hence it is taxed), income is taxed as it accrues and the net proceeds realised at the end of the investment term can be spent without incurring further income tax. This is the familiar taxed/taxed/exempt model which is the norm in New Zealand. Human capital would be similarly treated under an ideal income tax. There would be no deduction for tuition and other direct costs incurred and the growth in the value of the stock of human capital would be taxed each year. If the stock were sold the proceeds would not be taxed. This is obviously impracticable and thus in practice tax is deferred until the return from the investment is realised. The favourable tax treatment of human capital investment is a further reason for not supporting the subsidisation of tertiary education.

2.6.3 Education as a right

Advocates of a rights-based approach to tertiary education argue that "individuals have certain universal political, economic, and social rights ... that the state ought, as far as it is able, to protect and guarantee" (Boston, 1990). According to Boston this approach should be adopted in preference to the application of the principles of welfare economics.

The moral basis for such rights "lies in the intrinsic worth of human beings and the desirability of satisfying their many needs" (Boston, 1990). Boston argues that education is a good or service of significant value in the sense that it is important, if not essential, for human well-being and autonomy. Accordingly, if individuals are denied access to an education, they will be harmed in a potentially serious way. Boston, drawing on Grace (1990), argues that the right to be educated can be "defended" on the following grounds:

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[14] Cited by Todd *et al.* (1994).

- education is necessary for the development of rationality and autonomy and plays a crucial role in fashioning an individual's character, values, preferences, gifts, talents, and capacities;

- the acquisition of learning and knowledge is closely related to the acquisition of economic and political power. Consequently, access to education is vital if people are to enjoy the benefits and obligations of citizenship and contribute to the governance of their nation and world; and

- likewise, access to education is crucial for obtaining marketable skills and hence for the capacity of individuals to secure employment and enjoy the wider opportunities of life.

The same kinds of argument lead to the view that citizens have other rights, for example to food, clothing shelter and medical care. Advocates of a rights-based approach to education acknowledge that some rights are more important than others. Food and shelter are said to be more important than education because deprival of them would cause greater harm to the individual.

Boston notes that the acceptance of education or food as a right does not imply that it must be provided free of charge. According to Boston, a rights-based approach simply means that that if people are unable to satisfy their need for food, this need should be met by others.

The government's role in tertiary education cannot be established by debates on whether access to tertiary education is a 'right'. Choices about whether the government should intervene and, if so, how it should act and in what form must depend on a comparative assessment of feasible policy options. The view that education is a 'right' doesn't help to determine the quantity and type of resources that should be allocated to education. Current policies, which are supported by people who contend that access to tertiary education is a fundamental right, deny access to tertiary education for large groups in society, for example because entry criteria are not met.

Robertson (1997) notes that the idea that the state should provide education for all is descended directly from Marxist traditions and appears as a constitutional right for the first time in the Soviet Constitution of 1936. The argument is generally aimed at increasing the power of the state rather than acting as a check on it, which is the key purpose of human rights.

It is sometimes suggested that certain international conventions commit New Zealand to work toward the introduction of free tertiary education. If this view is correct, then New Zealand should seek to modify the relevant conventions or withdraw from them as they are unsoundly based.

2.7 Conclusion

The case on efficiency or equity grounds for large subsidies for tuition and research is weak. To the extent that capital market impediments justify government action, unsubsidised loan schemes, including loan guarantees, may be appropriate. In a report prepared for the NZBR, Professor Richard Blandy suggested that scholarships, loans and loan guarantees equal to, say, 30 percent of tuition fees be provided for students who maintain good standing (Blandy, 1988). The NZBR is not aware of any subsequent research which suggests that there are valid public policy grounds for a higher level of subsidy.

While the level of subsidy recommended is unattainable in the short term, there is a strong case for reducing subsides progressively. Moreover, the argument for lower subsidies is based on equity and efficiency principles and is independent of the level of participation in the tertiary sector. Priority should be given to reducing subsidies at a rate that enables students and their families to adjust. The forthcoming White Paper should present the case for lower effective subsidies (that is, taking account of subsidised tuition, living costs and loans) and outline a programme to reduce them to around 30 percent of tuition costs over 10 years. At the end of that period a further review should take place.

An increase in the level of private contributions would reduce government expenditure for a given level of participation. Resources freed should be used primarily to reduce government debt (future taxes) or the current tax burden. Investment in human capital would be encouraged by lower taxes, including expected future taxes.[15]

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15 Trostel (1993) estimated that a 1 percentage point increase in the rate of income tax in the United States would reduce the long-run stock of human capital by almost 1 percent.

3 REGULATORY ISSUES

The government has responsibility for establishing the general framework within which all firms and people interact. This comprises a system of property rights including, for example, processes to uphold voluntary contracts and to combat fraud and misrepresentation. Government involvement beyond the establishment and application of the general framework must be justified against valid public policy criteria.

The efficiency of the provision of tertiary education services is critical to the achievement of the government's goals. Despite this, the regulatory framework for tertiary education is inadequately addressed in the Green Paper. This is regrettable as opportunities to reduce the cost while increasing the quality of tertiary services obviously affect the financing burden borne by students and the taxpayer. Similarly, reductions in taxpayer financing would increase the incentive for students to demand a more efficient performance from providers.

From a regulatory perspective, the essential question is whether tertiary education can be supplied by private markets in much the same way as most other goods and services or whether there is something intrinsically different about it which requires such education to be provided by organisations that are subject to significant industry-specific regulation or by government-owned institutions.

3.1 Industry-specific regulation

3.1.1 Barriers to competition

Competition in the supply of education is the key to enhancing efficiency. This fundamental point does not appear to be adequately recognised in the Green Paper. Competition would encourage providers:

- to be more responsive to the needs of consumers. Consumers would be able to choose among a wider range of competing suppliers. Minority interests are likely to be better served within a competitive market where producers have a stronger incentive to exploit all profitable opportunities than in a politically controlled market where the interests of median voters tend to prevail. The tendering of broadcasting licences, which facilitated competition, has led to a wider range of radio services and greater specialisation by particular broadcasters;

- to innovate, for example to develop new courses and to modify or delete existing courses and to seek out new ways of delivering education and training. In the presence of weak competition, producers tend to argue that there are no better ways of meeting demand. Once competition is allowed, new entrants typically emerge to meet the needs of some consumers in superior ways;

- to increase productivity. Protected suppliers often argue that they are as efficient as possible, and that costs cannot be decreased without reducing the quality of services to unacceptable levels. This argument has proved to be without foundation on many occasions. Corporatised and privatised businesses have realised substantial efficiency improvements and provided consumers with superior services. Many observers believe that substantial productivity improvements are feasible in the tertiary sector; and

- to produce relevant information. Very little information is currently available on the demand for particular courses and on the delivery of education. As a consequence, decisions tend to be taken on the basis of inadequate information. In competitive markets producers are encouraged to collect information that is necessary to manage their businesses efficiently.

Where competition has been fostered in other sectors, real prices have fallen, the range and quality of services provided have improved, and productivity has increased. Telecommunications and air transport are examples. In these industries there is negligible pressure from the public to return to the former arrangements. This provides the clearest possible indication that increased competition has benefited consumers. Suggestions that increased competition would lead to 'dumbing down' are not supported by the evidence. The chief opponents of increased competition are providers – not consumers.

A detailed study of the benefits from regulatory reforms affecting airlines, railroads, trucking, telecommunications, television, banking, security brokerage, petroleum and natural gas in the United States found gains of at least US$36-46 billion (1990 dollars) annually (Winston, 1993). This amounts to a 7-9 percent improvement in the contribution of affected industries to GDP. Some net benefits could not be quantified. Most benefits accrued to consumers and, contrary to some expectations, employees and producers benefited. The facilitation of competition was a central feature of the reforms that were examined.

3.1.2 Entry and exit barriers

The Education Act 1989 provides for the establishment or disestablishment of tertiary institutions (universities, polytechnics, colleges of education and wananga) by the Governor-General in Council who acts on the advice of the minister of education. The Act defines each class of tertiary institution and requires that each provide a range of teaching and research appropriate to its characteristics. The minister is required to offer the New Zealand Qualifications Authority (NZQA) an opportunity to tender its views. The minister is also required to undertake certain consultations which may include discussions with competing institutions. The approval of courses rests with each institution's council.

Controls on the establishment and disestablishment of tertiary institutions are additional to the approval of courses and qualifications (see below). The purpose of such statutory controls is unclear. They appear to be directed at regulating entry into, and exit from, most of the formal tertiary education sector and seem to duplicate, at least to some extent, accreditation arrangements. The controls have the potential to restrict competition. Competitors are consulted on new entrants. Certain classes of institution have a preferred position, for example universities. Legislation entrenches the characteristics of tertiary institutions. These factors may restrict the development of more efficient types of education providers. The efficiency of the tertiary sector would be facilitated by the removal of unwarranted barriers.

The discussion in the Green Paper does not address entry and exit barriers satisfactorily. It focuses on controls on the use of particular terms such as university. It reports that broader regulatory issues are outside the scope of the present review despite their importance in addressing the government's concern that the tertiary sector is insufficiently responsive to changes in demand and its claim that it has adopted a two-decade time perspective. The NZBR recommends that the present rules be reviewed on a first principle basis with the objective of facilitating competition within the sector. We are sceptical that a valid case can be made for restricting entry into and exit from the tertiary sector.

3.1.3 Information problems

Many outputs and inputs of the tertiary sector are not specifically valued in markets and involve intangible qualities that are difficult to quantify and measure objectively. These features have contributed to the view that students and employers face high information costs in choosing among educational institutions and in evaluating graduates respectively. The Green Paper, for instance, reports that:

> ... it can be especially difficult or costly for students and employers to independently assess the value of tertiary education programmes and the quality of providers. 'Value' in education is inherently uncertain – for example, there is no guarantee that a particular qualification will in fact lead to employment. Also, standard measures which might let the quality of one programme or provider be compared with another (such as pass rates or student evaluations) have widely recognised shortcomings. This uncertainty about value signals a need for some regulatory supports to supplement the assurances of providers.

The preferred approach noted in the Green Paper is "to identify the minimum requirements needed to limit information costs to students while safeguarding the value of taxpayers' substantial contribution to tertiary education costs." According to the Green Paper, such requirements should (among other things):

- protect the value and international credibility of tertiary education in New Zealand;
- improve the information available to students to assist their choices; and
- apply consistently and transparently to all types of programmes and providers.

Information problems are pervasive in any economy. The relevant issue is the magnitude of information costs in the tertiary sector and whether government action can improve the outcome.

The general framework within which voluntary contracting takes place provides significant safeguards for consumers, for example through the Crimes, Fair Trading and Consumer Guarantees Acts and the common law. Beyond these general arrangements, the prime safeguards for consumers arise from incentives for providers to supply potential students and employers with information about the quality of services that they offer.

A range of private responses has emerged to address information problems. The following arguments need to be taken into account in addressing this issue, most of which were omitted from the Green Paper:

- people will tend to invest in information to the extent that it is worthwhile, and firms will generally supply information where it is efficient for them to do so. If students are better placed to obtain information, firms will not produce it;

- information is a scarce commodity that is costly to produce and communicate (Stigler, 1961). This leads to a demand for firms (both for-profit and not-for-profit) that specialise in the collection and dissemination of information. Information brokers enable consumers to access information at a lower cost than otherwise. There are groups in the education sector that provide information for consumers, for example career advisers employed by schools;

- the information held by consumers is not a matter of chance (Friedman, 1962). Students do not generally select tertiary courses and providers randomly. They typically seek advice from people who may be better informed such as parents, school teachers, older students who are currently at tertiary institutions and prospective employers. Repeat dealings with graduates provide employers with information on the reliability and quality of education providers. Where decisions are particularly important, for example because they may affect the long-term career prospects of students, they will tend to invest more effort than otherwise in acquiring information. Students may, for instance visit two or more institutions to explore the opportunities that are available and compare competing institutions and courses;

- all consumers do not need to be fully informed. From an economic perspective, it is decisions at the margin that are important because they affect key economic variables and performance. The fact that an individual is committed to enrolling at his or her local institution has no effect on incremental decisions relating to the supply and quality of services provided. What matters is the decisions of marginal students who are sensitive to small changes in prices and perceived quality. For the same reason, it is not necessary for all or even most consumers to search out education providers that offer appropriate combinations of service and price. It is the actions of marginal consumers that provide incentives for suppliers to seek to satisfy consumer preferences, and intra-marginal consumers effectively free-ride on the outcome of their research;

- institutional structures for the delivery of education services that emphasise the reputation of the supplier could be expected to develop in competitive education markets. Firms have incentives to inform consumers of the type and quality of services they provide. They invest in brands and advertising to convey their reputations. As Stigler (1975) noted in relation to retailing in the United States:

> The great merchandising dynasties – the Marshall Fields, the Macys, the Lazarus Companies, Sears Roebuck, and Ward – are famous for their standards of reliability, not for the skill with which they ignore a customer's complaints. Their main asset ... is their reputation for fair and careful dealing.

The same point applies to service suppliers. Following a relaxation in the regulation of the accountancy profession, the Institute of Chartered Accountants of New Zealand is implementing a strategy, including an advertising programme, designed to distinguish the services provided by its members from those of competitors. In an unregulated environment, franchise arrangements (for example McDonald's) and horizontal integration (Foodtown) may emerge to provide consumers with assurances of quality services. Developments along these lines have emerged in response to the constrained competition that currently applies in the tertiary sector, but there is scope for further advances as subsidies are reduced and made more uniform and other unjustified regulation is repealed; and

- advertising reduces the cost of identifying suppliers and of obtaining information on the services that are available and on their prices. Because advertising facilitates competition, it also generally results in lower quality-adjusted prices.[16] If a reduction in the price of a particular product were worth more to consumers than advertising expenditure, consumers would voluntarily demand less advertising and producers would exploit the opportunity.

Furthermore, the costs of regulation need to be taken into account. It is arguable whether the government faces appropriate incentives to regulate the quality of courses in the interests of consumers and whether it has any better information than that available to consumers. With government regulation, there is the risk that innovation will be constrained because regulatory processes tend to be captured by established producers. Producer interests rather than consumer interests usually advocate regulation that is said to be in the consumer's interest. Other costs include delays in obtaining approvals and the direct expense involved.

The standard response to significant information problems is to suggest that the government provide the information which it holds and which is not available to consumers and allow them to make their choices. Tertiary providers could, if they wished, subject themselves to voluntary certification

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16 See, for example, research reviewed by Pauly (1986) relating to restrictions on the advertising of medical services and supplies.

arrangements. It is doubtful whether regulation beyond such arrangements could possibly be justified on information grounds alone.

3.1.4 Accreditation

The Education Act established the NZQA with the objective of putting in place a consistent approach to the recognition of all national qualifications. An important function of the NZQA is to oversee standards for qualifications in secondary schools and in post-school education and training. The Act authorises the NZQA to accredit tertiary institutions, private and government training establishments and to approve their courses. In the case of universities, the power to approve courses is delegated to the Vice-Chancellors Committee which comprises the chief executives of competing providers.

The accreditation of providers and approval of courses are related to the statutory requirement on the NZQA to develop a framework in which all national qualifications have a relationship. This has been developed by the NZQA into a very rigid framework which has led to considerable opposition on both theoretical and practical grounds – problems which, no doubt, promoted the issue of the recent Green Paper on national qualifications .[17]

The NZBR is sceptical that mandatory accreditation of tertiary providers is justified. The present and proposed rules are akin to mandatory accreditation because public funding reinforces the NZQA's role. A private training establishment (PTE), for instance, cannot receive funding for courses unless it is accredited by NZQA. The proposals contained in the Green Paper would imply similar accreditation requirements in future with a minimum quality threshold, the continuation of large subsidies for tuition costs and a requirement that qualifications, programmes and providers be required to meet or exceed a minimum quality threshold to be eligible for government funding. Thus the suggestion in the Green Paper on the qualifications framework that registration with NZQA would be voluntary is of little relevance from an economic perspective.

The labour market provides signals to consumers on the relative value of qualifications obtained at different institutions. Employers do not treat all graduates from different institutions or all graduates from a particular course as equal. Employers are likely to prefer university to polytechnic graduates in commerce (other things being equal) because universities, unlike polytechnics, have an established

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[17] For a discussion of the development of the national qualifications framework and an evaluation of it largely from an education perspective see Irwin (1994) and Smithers (1997).

reputation in the area. Employers and students will discriminate among institutions, despite accreditation by NZQA.

The United States has a more diverse higher education sector than any other country. In the United States there are widely perceived differences in the quality of qualifications from different universities and colleges. In appointing staff, no one would argue that a New Zealand university should treat a doctorate from every university in the United States as of equal merit. The diversity of qualifications and standards need not diminish the reputation of individual institutions. This example demonstrates that the simple argument that the reputation of existing institutions would be compromised by more open entry into the industry does not withstand scrutiny.

The proposal to adopt a minimum quality standard that is to be consistent with international standards is inappropriate. There is no clearly defined international standard for tertiary education and the objective of strengthening the international credibility of New Zealand's education provision is doubtful. Some students may want to obtain a qualification that is recognised by the world's best universities and may be willing to bear the costs involved but many others may not. It is inappropriate to force them to bear the cost of satisfying the preferences of other students.

The proposed quality standard contained in Appendix C of the Green Paper confirms that central agencies are poorly placed to judge such matters objectively and thoroughly. Partington (1997) noted, in relation to the NZQA's unit standards for teacher education, that "[a] masterpiece cannot be distinguished from a fake by check lists such as the NZQA employs." A similar comment could be made in respect of identifying superior and inferior courses on the basis of a list contained in Appendix C of the Green Paper. It illustrates that government agencies focus on factors that are relatively easy to determine rather than the important factors that require judgment such as those that affect the quality of tuition provided.

There is no economic justification for each provider to be required to aim at a similar quality standard to that of other providers. Most markets provide consumers with choices of goods and services with different mixes of quality and price. The consumer can properly choose among Ladas, BMWs and many other brands of motor vehicles. Consumers and employers can be expected to require different levels of skills which a flexible education and training market should be capable of providing.

The combined effects of barriers to entry, accrediting by NZQA and subsidy arrangements produce a system that approaches mandatory accreditation. Mandatory accreditation imposes the following costs on the community:

- it encourages excessive conformity. This impedes the responsiveness of education providers to changes in demand. Providers are required to obtain approval for courses and qualifications from accrediting agencies which tend to support conformity with the industry norm. In the case of universities, approval is required from a body comprising the provider's competitors. How can they be expected to act totally in the national or the consumer's interest and not be influenced by their institution's self interest? According to the proposal contained in the Green Paper, one of four tests of whether programmes are well designed will be whether all interested parties have been consulted and had an input into their design;

- it reduces the incentive for providers to develop and protect their reputations. Under the qualifications framework, qualifications awarded by poorly performing organisations are required to be recognised as equal to similar qualifications conferred by other providers. The Green Paper states that the minimum quality standards would include qualification portability. This reduces the incentive for poorly performing providers to maintain standards and impedes the establishment of independent standards by high quality institutions;

- it may provide inadequate or misleading information. Accreditation systems depend on reliable information about each institution's courses and qualifications, which is costly to obtain. Accrediting agencies cannot expect to obtain reliable information on the quality of particular qualifications, programmes and providers because the incentives facing providers and the agency are inappropriate and the relevant information is dispersed among many people. The previous example illustrates the point. If institution A states that a qualification awarded by institution B is not an acceptable prerequisite for entry at the next level, it provides information to consumers on its opinion of B's course. If all qualifications are portable, consumers are presented with misleading information on institution A's real assessment of the course;

- it imposes compliance costs on providers including the direct costs of preparing submissions and supplying information. Indirect costs may be larger. They include the costs of delays, inappropriate courses and qualifications designed merely to satisfy the accrediting entity's requirements, and the costs of dealing with the agency. The compliance and implementation costs of the national qualifications framework are likely to be substantial; and

- it encourages lobbying. The value to employees of qualifications depends on their scarcity value. Employees can be expected to prefer generic qualifications which enable them to move among firms and industries (if other factors are equal). Holders of qualifications have an interest in restricting the supply of people with similar qualifications, knowledge, skills and attitudes. This helps to explain attempts by professions, such as medical practitioners, to control entry into their profession and to raise entry standards. Employers will seek qualifications that accurately signal to them that the employee or applicant has the ability, attributes, knowledge and skills required for entry or progression and is suitable for firm specific training. The interests of employees and employers may differ. The interests of employee and employer organisations may also differ from those of their members. These conflicting interests lead to pressure on accrediting authorities aimed at enhancing self interest at the expense of the community.

There is no evidence in the Green Paper that these costs have been adequately examined. The interests of consumers would, in our view, be better promoted by the development of a more competitive market for tertiary education and training with responsibility for standards placed firmly on individual providers.

If an accreditation system were to be provided it should be truly voluntary and less intrusive than present arrangements, should allow for greater diversity, and should be based on minimum requirements that are clearly promulgated in legislation or statutory regulations. Institutions should not be required to give credit for qualifications obtained at other institutions and the views of competitors should not be taken into account in establishing new institutions and courses. In addition, new institutions should not be required to be structured on the same basis as the present large scale multi-faculty institutions. New entrants and existing institutions should be free to adopt the most efficient structure, which is likely to change over time.

3.1.5 Funding biases

Tertiary funding is substantially biased in favour of state providers. Aside from Skill Enhancement and TOP courses, few private providers are funded. When funding is granted to a private provider (other than for Skill Enhancement and TOP) the actual level of subsidy is substantially less than any counterpart course at a state institution. PTEs, for instance, receive a lower maximum rate of subsidy for all courses than tertiary institutions receive for their lowest cost courses (extramural study).

Because requests for funding from PTEs exceed available funding, the actual rate of subsidy provided is generally less than the maximum rate available for PTEs. Uncertainty concerning future funding arrangements deters private investment in tertiary education facilities. It is not surprising, therefore, that PTEs have targeted unmet demand for courses that are not provided by tertiary institutions, and have not generally competed head on with them. On the other hand tertiary institutions have tended to introduce courses (for example, hairdressing) which compete with those initiated by PTEs.

The bias in favour of state funding impedes competition. It is also inequitable because it discriminates against people who pursue courses at private institutions, many of whom come from disadvantaged backgrounds. A majority of the MCG recommended that PTEs be permitted to progressively compete on more even terms with state providers of tertiary education and training. The advocates of Option B recommended that there be greater neutrality of funding between private and state funded providers under the loans and EFTS schemes. Government policy has moved tentatively in this direction but it has not gone anywhere near far enough. The Green Paper raises neutral funding as an option but does not state a conclusion.

As argued above, public benefits that would not be obtained in the absence of government action and the promotion of equity are the only possible grounds for government subsidisation of tertiary education. Neither of these grounds requires that education be provided by publicly owned institutions. The question of whether public benefits arise centres on the nature of the education and training provided rather than the ownership of the provider. Similarly, equity issues arise in relation to the individual student's circumstances and not whether the provider is publicly or privately owned. The argument noted in the Green Paper, that a neutral funding policy would raise ownership risks for the Crown, is true but it is an inappropriate consideration. It highlights the potential for conflict among ownership and other roles of the government.

Subsidies provided on public benefit or equity grounds should be available for courses offered by state and private providers. They should also be available to students wishing to study overseas. The government should adopt a planned programme to phase in neutral funding by the academic year that commences in 2002. The achievement of such a target would be assisted by the progressive reduction in the level of tuition subsidies for courses provided by state providers.

One consequence of moving toward neutral funding is that the government would be required to set explicit criteria for courses and programmes that are to be subsidised on public benefit grounds. This has been largely avoided in the past by funding state institutions and effectively delegating course approval to institutions and later the NZQA. While it might be argued that rules relating to the establishment of institutions and their accreditation by NZQA are intended to do this, there are no provisions in the legislation that direct those organisations to focus on public benefits in making their decisions. The Green Paper also failed to distinguish between the claimed grounds for subsidisation and the information cost arguments which are said to justify accreditation.

A transparent funding policy, separate from a consumer protection policy and based on sound principles, is required if subsidies are to be continued. The government needs to be explicit about why it is subsidising tertiary education and the boundaries of such education. In our view this is a demanding task and, judging by the quality of the Green Paper, the resources of government agencies will needed to be upgraded to accomplish it satisfactorily.

3.2 Ownership issues

Because of their size and significance, the provision of tertiary education and training will be dominated by state institutions in the medium term, even if competition is facilitated. Moreover, if significant public funding of providers is continued, consumers will have less influence than otherwise on the efficiency of providers. For these reasons, it is important that state institutions are encouraged to become as efficient as possible. Productivity improvements would help to offset fee increases.

State providers currently face inadequate incentives to improve their efficiency for the following reasons:

- high levels of government subsidies are available for courses provided by state institutions. They reduce the incentive for consumers to monitor the performance of state tertiary providers. Marginal consumers are concerned that the value of their courses is at least equal to the private cost (including forgone income) which they bear. Because the cost of tertiary education to the student is well below its cost to the community and external benefits are doubtful, marginal social benefits can be expected to fall short of marginal social costs. At the same time the government has done little to monitor the performance of state providers. If students pay higher fees they would be encouraged to monitor more closely the services provided by tertiary institutions;

- competition from private providers is constrained by non-neutral funding arrangements, barriers to entry and exit, and accreditation requirements. There is only limited competition among state providers, some of which benefit from a degree of natural protection arising from their location. The government does not, for example, tender the right to provide all courses on the basis of cost and quality. While the EFTS system has some elements of a tender system, all state providers receive a set level of funding for each class of course. The EFTS system encourages institutions to expand their rolls rather than to compete on grounds of cost and quality;

- state institutions are not required to earn a return on their capital investment as capital charges have not yet been applied. The absence of a capital charge could be expected to produce excessive operating costs. It would lead to unjustified investment in land, buildings and equipment because the opportunity cost of capital is not required to be fully taken into account. These factors confer a competitive advantage on state providers;

- the residual owner (that is, the person or institution receiving any surplus after all other claims have been met) of state institutions is unclear. As a consequence, monitoring by owners who have a direct stake in the financial performance of state institutions is weak (see Evans, 1997). Inadequate monitoring by residual owners can be expected to lead to excessive costs, poor returns on investment and an insufficient focus on key objectives. In addition, management and staff interests are likely to dominate the residual owner's interests; and

- The structure of councils, which is prescribed in legislation, is unwieldy and reflects a range of interests such as employers, unions, staff and students that are inconsistent with the management of residual risk. Furthermore, the accountability of councillors is weak. Not surprisingly, councils have become lobbyists for their institutions and they frequently criticise sound policy proposals (for example, reductions in subsidies and the application of capital charges).

Some of these weaknesses are noted in the Green Paper. There are two main policy options for addressing them. First, state institutions could be privatised. Secondly, governance arrangements could be improved.

3.2.1 Is state ownership of tertiary institutions desirable?

The discussion in the Green Paper assumes that state ownership of tertiary institutions is desirable. It states that:

> The reasons for public ownership of TEIs are mainly historical. Typically, the key reason advanced is a judgment that public ownership is necessary to safeguard the Crown's resourcing interest in tertiary education. Without ownership, the Government might find it difficult to ensure that tertiary education services are directed towards its overall education strategy and goals.

This is a woefully inadequate argument. It overlooks the role of PTEs which provide subsidised courses, confuses the government's ownership and funding roles and is inconsistent with the approach taken elsewhere in the public sector. Moreover, government ownership of tertiary institutions is not justified by the objectives contained in the Green Paper or on public benefit, equity, capital market failure or information grounds. Academic freedom would be advanced if the state were to quit its ownership interest in tertiary institutions.

There is no discussion in the Green Paper of alternative ownership structures for state institutions, such as private for-profit or not-for-profit firms like trusts. Some tertiary education is provided privately in New Zealand and private institutions are prominent in countries such as Japan and the United States. Two universities have been privatised in Sweden and there has been a move to a more mixed public and private system in Chile.

In the past, perceived market failures such as inadequate competition were often addressed by the public ownership of business enterprises. However, analysis suggests that weak incentives facing politicians and bureaucrats mean that private ownership is, on average and over time, more efficient than public ownership. The World Bank (1992) found that a superior performance is difficult to achieve and sustain when businesses are under government control. Although the stimulus of competition helps, incentive and monitoring problems associated with SOEs and Crown entities cannot be addressed fully with public ownership. A World Bank paper (Nellis, 1994) asked, 'Is privatisation necessary?' It then stated:

> The answer is a decided "yes". Privatisation is necessary, and not simply to improve performance of public enterprises – though the evidence is striking that it can and does improve performance. Privatisation's essential contribution is to "lock in the gains" achieved earlier by reforming public ownership ... ; to distance the firm from the political process; and to inoculate the company against the recurrence of the common and deadly ailment of public enterprises: interference by owners who have more than profits on their minds.

Nellis could also have noted that interference by politicians and bureaucrats who have objectives separate from those of organisations such as TEIs could pose a serious threat to them. We would also expect inefficiencies in state education institutions to at least match those of state-owned businesses in other sectors.

A possible objection to the privatisation of tertiary institutes is that education is too important to be undertaken by private organisations. However, tertiary education is an economic product like any other. People derive benefit from its consumption and, if it is priced correctly, will trade off the benefits of investing in additional education against those that arise from buying other goods and services that they may prefer. Moreover, most essential goods and services, like food, are produced in the private sector.

Apart from policy-induced distortions such as preferential tax treatment, the main explanation that has been advanced for the limited role played by for-profit organisations in tertiary education is that donors cannot be persuaded to make contributions to organisations that can simply declare a dividend of all money received from external sources (see Epstein, 1995). This argument assumes that tertiary institutions are, or should be, dependent on a high level of donations. While this may be true for research-oriented institutions in some countries, it is not necessarily the case in New Zealand where most tertiary institutions focus on the provision of tuition which can be funded by fees and, where justified, subsidies.

A related argument is that alumni donations may provide institutions with the incentive not to undermine the perceived value of the qualifications they award by lowering standards. They may also signal customer satisfaction. These arguments may lead to not-for-profit rather than for-profit entities in some circumstances but they do not support state ownership of tertiary institutions.

It is difficult to identify compelling grounds for continued public ownership of existing state educational institutions in New Zealand. The government should examine carefully whether they should be privatised on a for-profit or not-for-profit basis.

3.2.2 Governance arrangements

If the government retains an ownership interest in tertiary institutions it should:

- determine where the residual ownership interest in state tertiary institutions resides. This issue is raised in the Green Paper but the discussion is brief and inconclusive. It must be resolved if progress is to be based on a sound footing;

- establish the objectives of the residual owners of state tertiary institutions and implement appropriate monitoring and accountability arrangements. The Green Paper focuses on these matters;

- provide for the appointment of a governing body (council or equivalent); and

- provide a system for internal management that will facilitate efficient operation (for example, appropriate contracts with chief executives and employment of staff on individual contracts, together with appropriate arrangements for performance assessment).

The proposals relating to governance, which is the only area where the Green Paper proposes significant changes, can be improved upon. There is a strong case for much smaller councils of, say, 7 to 9 members including the chief executive, comprising a majority of ministerial appointments with the balance co-opted. An independent board should be established to recommend ministerial appointments and thereby enhance academic freedom. There are no grounds for elected staff and student representatives to be appointed to councils. However, academics or students could be co-opted on the basis of their ability to contribute to the work of the council.

The proposal to enhance the authority of state tertiary institutions and to vest assets in them is endorsed, provided that governance arrangements are improved as suggested.

3.2.3 Capital charge for state institutions

The proposals in the Green Paper include a requirement for state tertiary institutions to meet a cost of capital charge as part of their normal annual operating costs. A cost of capital charge is intended to encourage such institutions to take better account of the opportunity cost of capital in their decision making. It could be expected to lead to a more appropriate mix of current and capital inputs, and it would help to place state institutions and competing private providers on a more equal footing. SOEs and Crown entities are generally required to pay dividends to the Crown or to bear a capital charge.

The proposal to apply a capital charge has been investigated and debated at length. The resistance of state institutions, particularly their argument that some of them will be more adversely affected than others, highlights the potential benefit from such a charge to the wider community. It is time for the government to implement it – unless the issue is addressed in the broader context of privatisation, which would be a superior solution.

3.3 Conclusion

There is growing evidence from a wide range of countries that regulatory reform is highly profitable for society. There is every reason to expect that a more appropriate regulatory environment for the provision of tertiary education and training in New Zealand would also produce substantial net benefits.

Competition in the provision of formal tertiary education is severely impeded by inappropriate government policies. In particular, the government's general regulatory, funding and ownership roles appear to be interwoven. A clearer separation of these roles would help promote competition.

The key steps that are required to improve the efficiency of tertiary education and training are:

- to facilitate competition by removing unwarranted barriers to entry into, and exit from, the industry;

- to examine on a first principles basis the grounds for accreditation arrangements;

- to provide competitively neutral funding for education supplied by private and state providers;

- to encourage providers to be more responsive to consumers by linking public funding more directly to student enrolments; and

- to establish existing state educational institutions as either for-profit or not-for-profit organisations independent of the government.

4 RECOMMENDATIONS

The NZBR recommends that the government:

- note that there are compelling efficiency and equity grounds for reducing subsidies for tertiary education;

- note that no information has been produced which suggests that subsidies in excess of 30 percent of tuition costs, as recommended by Professor Blandy in 1988, are justified;

- agree that the forthcoming White Paper should present the case for lower effective subsidies (that is, taking account of subsidised tuition, living costs and loans) and outline a programme to reduce them to, say, 30 percent of tuition costs over 10 years. At the end of that period a further review should take place;

- agree that subsidies provided through the student loan scheme be phased out. This would require the adoption of a market rate of interest, the accrual of interest and the introduction of a fee for the actuarial cost of the insurance element embedded in the present scheme;

- agree that more efficient provision of tertiary education and training be encouraged by:

    - facilitating competition through the removal of unwarranted barriers to entry into, and exit from, the industry;

    - examining on a first principles basis the grounds for accreditation arrangements;

    - providing neutral funding for education supplied by private and state providers;

    - encouraging providers to be more responsive to consumers by linking public funding more directly to student enrolments; and

- establishing existing state educational institutions as either for-profit or not-for-profit organisations independent of the government.

ANNEX

Summary of the Green Paper and NZBR Comment

Issue	Green Paper	Comment
Goals for the next two decades	Improving opportunities for participation. Improving the participation and achievement of currently under-represented groups. Improving incentives for the quality of qualifications, programmes and providers [to reach an acceptable national and world class standard]. Encouraging value for the student's and the government's financial contribution.	The objectives are unrelated to the proper role of the government. This should be to establish a framework which would enable tertiary education to make the largest possible contribution to the advancement of community welfare. The objectives do not focus on the key issues that need to be addressed. They are far from ambitious given a two-decade timeframe and are imprecise. How would anyone determine whether they have been met? The proposals contained in the paper are inconsistent with, or poorly linked to, the objectives. The emphasis on increasing participation in tertiary education by particular groups suggests a targeted response (e.g. scholarships). There is, however, no discussion of measures aimed at the target groups.
Level of tuition subsidies	The levels of government assistance will be guided by the government's desire to ensure access to tertiary education by all who can benefit from it, while retaining prudent control of government expenditure. Greater government spending is to be considered in relation to where the tax burden falls. The government will take into account the impact of lower subsidies on the level of participation, the need for some certainty, the scope for students to make the best use of their subsidised tertiary education, the scope for providers to be innovative and to seek productivity gains, and the overall level of assistance provided to the tertiary sector. As participation increases, any government will need to make trade-offs between voting extra resources to cover costs and sharing out resources.	There are no specific proposals on the level of funding. This is a key issue that should be addressed on a first principles basis as discussed in this submission. The Green Paper falls well short of its claim of wanting "to talk about where we want to go over the next twenty years and more." There is insufficient focus on efficiency considerations. The paper avoids a conclusion on them. It emphasises equity concerns without reaching an explicit conclusion. The level of discussion is superficial. There are no references to the literature. The discussion is less rigorous than that contained in the MCG report. The Green Paper implies that the level of per student funding will depend on participation rates. There are no valid public policy grounds for this view.

Summary of the Green Paper and NZBR Comment (Continued)

<table>
<tr><th>Issue</th><th>Green Paper</th><th>Comment</th></tr>
<tr><td>Allocation of subsidies among students</td><td>The government wants to share resources among students in a way that maximises access and participation, especially for students undertaking tertiary study for the first time.

Two options proposed are sharing the government's contribution between all tertiary students (option A) or targeting subsidies to those students with the least previous tertiary education (option B).

Option B could entail a set level of subsidy per student.

If option B is selected there is a choice between the provision of the full subsidy for an initial programme and retaining some proportion of it for later up-skilling .

If Option B is selected a student co-payment could be required or the student could use his or her subsidy to pay for the course.

Three options are to pay a flat subsidy for all courses, a differential subsidy that reflects course costs or a flat subsidy with supplements for expensive courses.

Funding on the basis of a student entitlement or a modified bulk-funded system is proposed.

The issue of whether funding should be provided on the basis of enrolments or enrolments and completions is raised.

Private training establishments could be funded on the same basis as state-owned institutions or the present non-neutral basis could continue.

Students studying overseas could be subsidised or the present policy of restricting subsidies to domestically provided courses could be retained.</td><td>Wider issues relating to the role of the government need to be considered. The level of subsidy and the courses and programmes for which subsidies are to be provided should be determined on public policy grounds that justify government action.

The discussion implies that the government favours option B with a fixed subsidy level for each student.

A life entitlement to subsidies for tertiary education that is not derived from the application of valid public policy criteria is opposed.

The paper is vague. It fails to spell out the implications of the choices suggested. There is no discussion, for example, on how the level of a fixed subsidy would be set and how it would differ from that presently provided.

The proposals are likely to lead to complex rules specifying student entitlements and accounting for their use over the life of each student.

The level of subsidy provided should reflect the marginal public benefits that are expected to be realised. The question of co-payments and supplements should then be determined.

If subsidies are provided to students or to institutions on the basis of student enrolments or completions, institutions are more likely to respond to the preferences of students. But this will only be efficient if the subsidies provided reflect appropriate public benefits.

Neutral funding between state owned and PTEs is desirable to foster competition.

Competition between domestic and offshore providers would be facilitated by subsidising students who study abroad. The issue is not the location of the provider but the level of public benefits derived by the wider community</td></tr>
</table>

Summary of the Green Paper and NZBR Comment (Continued)

Issue	Green Paper	Comment
Allocation of subsidies among students (continued)	Funding for industry training may not be restricted to NZQA-approved courses. Trainees would use up their fixed level of subsidy if they undertook industry training that is subsidised. Students undertaking Skill Enhancement and TOP courses would not use up their fixed subsidy level.	If the policy advocated in the Green Paper were consistent, immigrants with tertiary qualifications would be subsidised to encourage their contribution to extra marginal public benefits while graduates who migrate would be taxed to reflect their failure to contribute public benefits for which they were funded in advance. The proposal relating to Skill Enhancement and TOP courses can be viewed as the granting of damages against the Crown for the failure of its schools. A more formal contact for the supply of schooling would strengthen incentives at the school level.
Research	Either post-graduate degree providers or all degree providers are to be required to undertake research to assure the quality of their teaching. Research could be funded either on the basis of student enrolments in degree programmes that require research activities or on a contestable basis. Minimum standards could be developed, specifying the quantity and quality of research activities funded through Vote Education or providers could be required to report annually on research outputs.	The fundamental question is why should the government regulate whether institutions undertake research? There are no valid public policy reasons to require tertiary institutions to undertake research. The grounds for subsidising research, aside from contestable public goods funding, are doubtful. In a competitive model, the most efficient combinations of teaching and research would emerge. Government agencies are unlikely to be well placed to evaluate research outputs.
Regulatory issues	Regulation is needed to reduce information costs and to achieve value for the taxpayers' contribution to tertiary education. The minimum regulatory requirements should protect the value and international credibility of tertiary education in New Zealand, reduce unwarranted barriers to entry by new providers or those wishing to provide new courses, and improve information for students. They should apply consistently and transparently to all providers.	The government's ability to reduce information costs efficiently is doubtful. Publication of any information that it holds, for example through voluntary certification, is the most that could be justified. The government should place greater reliance on competition and less on industry-specific regulation than envisaged in the Green Paper.

Summary of the Green Paper and NZBR Comment (Continued)

Issue	Green Paper	Comment
Regulatory issues (continued)	The government could establish a minimum quality threshold that is consistent for all qualifications, programmes and providers or the threshold could be validated externally. The latter is preferred. The quality standard approach outlined in Appendix C of the qualifications Green Paper is suggested. Certain terms such as university, degree and doctor are to be protected. Maori could determine whether the term wananga should be restricted. Providers are to be required to supply information on the quantity, quality and price of tertiary education. The information is to be made available to the public.	The view that the government should regulate the tertiary sector to maintain its international standing is misguided. See submission for elaboration of this view. Unwarranted barriers to entry should be removed. The Green Paper does not identify them. The advantages enjoyed by state institutions are the main barriers to competition. Course approval processes involving competitors is a further example. The proposed quality standard illustrates that central agencies are poorly placed to judge objectively and thoroughly such matters. Quality standards would effectively be mandatory because government funding is tied to compliance with them.
State institutions	The government's ownership interests are to ensure the provision of high-quality education, research and related services that provide a platform for financial viability, an acceptable and well managed financial risk, effective accountability, continuity of supply, to address any critical failures, and to protect academic freedom. This issue of whether the state holds the residual ownership interest in tertiary institutions is raised but the discussion is brief and inconclusive. Members of governing bodies are to be appointed on the basis of skills and competency taking into account the contribution of the academic community, gender and ethnic balance, and representation from the local community. A single governing board is proposed but a two tier structure is also discussed.	The key issue of whether the government should retain an ownership interest in tertiary institutions is not examined. The argument for state ownership is weak and inconsistent with the approach adopted in other sectors. The Green Paper confuses general regulatory and ownership issues. State providers currently face inadequate incentives to improve their efficiency. State institutions should be established as private for-profit or not-for-profit organisations. Academic freedom would be advanced by the privatisation of state institutions. The proposals perpetuate a stakeholder view of governing bodies. Their membership should reflect the capacity of appointees to contribute.

Summary of the Green Paper and NZBR Comment (Continued)

Issue	Green Paper	Comment
State institutions (continued)	The responsible minister and governing boards are to agree annual statements of intent. Annual business, operational and monitoring reports are to be provided. Expected ownership performance is to be specified. Governing boards are to have a high degree of delegated authority. Assets are to be vested in state-owned institutions. A cost of capital charge is to be introduced. State institutions are to be established as public tertiary education institutions based on the Companies Act but without a profit motive or as statutory corporations under the Education Act.	The majority of members should be ministerial appointees. The establishment of an independent board to recommend appointments to councils of state institutions would enhance academic freedom. The size of governing bodies should be reduced. Clarification of the role of the responsible minister and the specification of required performance are desirable steps. A cost of capital charge is desirable if the state retains an ownership interest in tertiary institutions. Central controls over state institutions should be relaxed with emphasis placed on better governance arrangements.

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