

NEW ZEALAND BUSINESS ROUNDTABLE

**SUBMISSION ON THE TERTIARY EDUCATION
REFORM BILL**

MARCH 2002

Introduction

1.1 This submission on the Tertiary Education Reform Bill (TERB) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 In our submission, we do not undertake a clause-by-clause analysis of the TERB. Rather, we:

- discuss some of the broad policy issues arising from the TERB;
- highlight areas of the TERB that we support and those where we have concerns; and
- suggest ways in which the TERB measures could be implemented so as to increase the likelihood that the reforms will generate net benefits to the country.

1.3 We also identify a number of wider policy reforms that would help achieve the goals being sought by the government through the TERB.

Summary

.4 Key points in the submission are as follows:

- The NZBR supports some aspects of the TERB and associated reforms, including its focus on objectives, information and sector performance.
- At the same time, we are concerned that the underlying justification for the increased centralisation of decision-making authority in the tertiary sector is

weak. For example, there is little evidence that competition is having an adverse impact on sector outcomes.

- We have considerable reservations that central 'steering' will deliver better outcomes than could be realised under a more decentralised system. The current system is not perfect by any means. However, a range of reforms aimed at supporting the operation of a decentralised system, including better quality assurance mechanisms, improvements to institutional governance and better information, would likely yield superior outcomes to what is being proposed in the TERB.
- The success or otherwise of the TERB proposals will depend on the way it is implemented.
- To the extent that the various regulatory instruments such as the TES, the TEC and charters and profiles are used to micro-manage the sector, they will introduce rigidities into the system, weaken market signals and frustrate, rather than promote, the achievement of government objectives.
- In our view, the only way that the TERB approach will generate net benefits to the country is if it is implemented in a 'light-handed' manner, with the government and the TEC focussing predominantly on information provision and performance measurement.
- While we believe that an alternative policy direction to that outlined in the TERB would be preferred, we also believe that the TERB could be improved in a number of ways. These include making changes aimed at reducing the scope for arbitrary decision-making, ensuring that the assessment criteria are based on well-founded public policy criteria and ensuring participation by, and consultation with, stakeholders, including business and enterprise.

- Whether the TERB goes ahead or not, a range of wider, more fundamental tertiary education reforms should be considered, including eliminating the fee-stabilisation programme, revamping governance arrangements and reversing recent student loan changes, all of which were identified as issues by the Tertiary Education Advisory Commission (TEAC).
- We recommend against industry levies. If, however, the government proceeds with them, we recommend that levies only be put to a ballot where they meet a strict desirability test, as currently exists with the Commodity Levies Act 1990. The ballot threshold should be set much higher than is currently proposed.

3.0 Key elements of the TERB

.4 The TERB has been developed as a response to the first two reports of the TEAC. Consistent with TEAC's work, the stated rationale for the changes is to make more strategic use of resources through a more cooperative and collaborative tertiary education sector. Broadly, the TERB provides for greater centralisation of decisions and more power for the Associate Minister of Education (Tertiary Education).

.5 Key elements of the TERB are as follows:

- the Tertiary Education Commission (TEC) will be established from 1 July 2002, with a board of 6-9 people. The board will make the key decisions, not the staff;
- the Minister will set a long-term Tertiary Education Strategy (TES) and a shorter-term Statement of Tertiary Education Priorities, to be implemented by TEC;
- all funded providers will have to prepare 5-10 year charters and 3-year profiles (updated annually) for negotiation with the minister and TEC, respectively. Providers will need to consult with stakeholders over charters, at least;

- the minister will approve funding mechanisms, prepared by TEC, although the minister can not intervene in a particular organisation's funding;
 - a new class of Tertiary Education Institution (TEI) – specialist colleges – will be established;
 - the New Zealand Qualifications Authority (NZQA) will be able to suspend or place conditions on registration, course approval and accreditation; and
 - Industry Training Organisations (ITOs) will be required to forecast skills for their industry and will be able to ballot their industry to determine whether an industry levy should be established.
- **Assessment of TERB**

.4 *Regulatory approach underlying the TERB*

.5 There are several positive aspects to the TERB and associated reforms. These include:

- the TES can help to focus tertiary sector participants and the government on sector objectives, outcomes and performance, rather than focusing on the means of achieving these objectives;
- the TERB and associated reforms put considerable focus on the role of information in supporting the operation of the education and labour markets. This was true, for example, of the November 2001 package¹ of skills forecasting initiatives, which focused on increasing market transparency and forecasting future skill needs, rather than attempting 'old-style' workforce planning;²

¹ Maharey, Hon Steve (2001), *Government to introduce skills forecasting*, Press Release, Government of New Zealand, 14 November.

² Willems, Ed (1996), *Manpower Forecasting and Modelling Replacement Demand: An Overview*, Research Centre for Education and the Labour Market, Maastricht.

- the unified funding framework for the tertiary education sector will provide greater coherence in the way the sector is funded; and
- charters and profiles could push tertiary institutions (state and private) to put a greater emphasis on strategic planning, an area identified as a weakness by the Tertiary Capital Charge Task Force and Steering Group during the mid 1990s.

.4 At the same time, however, we are concerned that the underlying policy of increased centralisation of decision-making authority in the tertiary sector is mistaken. One of the justifications for this proposed policy direction is that a more 'centralist' and less 'competitive' approach is required to ensure that tertiary education in New Zealand makes more strategic use of available resources. For example, the second TEAC report, which recommended the adoption of charters, profiles and the TEC, argued, *inter alia*, that:

- 'excessive reliance' on a demand-driven funding system and competition has had a number of adverse impacts on the tertiary education sector, including creating pressures on providers to compete across a wide range of disciplines and causing a proliferation of courses; and
- the government has limited capacity to intervene in the tertiary sector to protect the national interest.³

.4 A key concern is that neither the second TEAC report nor the TERB provides any justification or evidence to support the policy approach that underlies the TERB. Yet, the approach has potentially far-reaching implications. There are several key issues that have not been addressed. For example:

- it is not clear that the TEAC characterisation of the tertiary sector is accurate. In particular, no evidence is provided to support the view that sector is too

³ Tertiary Education Advisory Commission (2001), *Shaping the System*, Wellington, pp 8-9.

'competitive', that there is a lack of cooperation/collaboration in the sector, or that the sector is insufficiently strategic;

- the underlying view that competition is 'bad' is not supported by the evidence, either in the education sector or in other parts of the economy. Moreover, competition arises because resources are scarce (that is, there are more wants than can be satisfied with available resources). TEAC did not recognise this fundamental point. Its proposals do not overcome scarcity; they merely change the process by which resources would be allocated among competing uses;
- it is not clear why a competitive model of tertiary education would generate 'too little' cooperation and collaboration, when other, more competitive sectors exhibit significant collaboration; and
- it is not clear that the proposed 'centralist' approach to steering the tertiary education system via charters and profiles will yield better tertiary outcomes than the 'decentralised' system currently in operation.

.4 This is of concern given that good problem definition is essential to developing an appropriate policy package. Indeed, poorly specified problems can lead to poorly specified solutions. A strong policy platform is essential if policy changes are to be effective and durable.

.5 It is not clear that the TEAC/TERB characterisation of the tertiary education sector is accurate. Contrary to this view, a cursory glance at the sector suggests that it is not homogeneous and that in fact there is a fair degree of specialisation. For example:

- different institutions have developed expertise in particular programme areas (eg public administration at Victoria, medical sciences at Otago);
- institutions go to great lengths to differentiate themselves, through various means, including the development of a different institutional focus and emphasising non-academic factors such as lifestyle;

- many PTEs focus delivery on a narrow range of courses and do not compete directly with the 'full-service' state institutions which are their main competitors;
 - the tertiary sector is far more differentiated than the more heavily regulated and less 'competitive' school sector in New Zealand; and
 - institutions may differ along many dimensions, even if they have similar course and programme offerings (eg applied versus theoretical focus, pastoral care, size).
- .4 The view that the tertiary sector is not homogeneous is supported by the OECD which, in 1997, described the New Zealand tertiary sector as follows:
- There is a considerable measure of specialisation in the tertiary system, not only through the sectors which comprise it (universities, polytechnics, colleges of education, Wananga – specialist Maori institutions – and private training establishments – PTEs) but also within each of the sectors. The universities, for example, while offering a broad range of programmes, specialise in certain fields.⁴
- .5 A second underlying premise of the TEAC and the TERB is that competition in the tertiary education sector is somehow bad. In our view, it is not clear why competition and 'duplication' are inherently undesirable in tertiary education.
- .6 Competitive markets are a reality across a wide range of sectors of the economy – including education. Competition is generally seen to be a good thing. It offers consumers convenience and choice, and ensures that providers have strong incentives to innovate, to be responsive to customer demands, to provide the levels of quality desired by consumers and to deliver services in an efficient manner. Neither TEAC nor the TERB provides reasons why competition would have the opposite effect in the state tertiary education sector. Nor do they explain why tertiary education might be different from other goods and services,

⁴ OECD (1997), *Thematic Review of the First Years of Tertiary Education, Country Note: New Zealand*, Paris, p 12.

for example, general medical practitioner services, where competition is seen as providing better outcomes for consumers.

- .7 Regulatory reform initiatives aimed at promoting competition have been successfully applied across a wide range of sectors in the economy – including areas where competition was previously not seen as viable. These include public transport and social services such as health and education.
- .8 A number of studies covering a range of 'economic' sectors and countries have examined the experience with deregulation and the introduction of competitive forces. These studies have identified significant gains from regulatory reform – including higher quality, lower consumer prices, greater choice and increased innovation. For example:
 - Guasch and Hahn cite significant efficiency gains from regulatory reform in developing countries across a range of industries;⁵
 - an OECD review of economic deregulation initiatives in the United States concluded, *inter alia*, that more vigorous competition in network industries "stimulated industry restructuring and innovation and benefited consumers through better service and lower prices";⁶
 - Winston found that deregulation had led to price declines ranging from 30-75 percent across a range of industries, including airlines, trucking, railroads and banking;⁷ and
 - Crandall and Ellig found that regulatory reform and the introduction of customer choice in five 'network' industries led to improvements in service

⁵ Guasch, J Luis and Robert W Hahn (1999), *The Costs and Benefits of Regulation: Implications for Developing Countries*, The World Bank Research Observer, vol 14, no 1, pp 137–158.

⁶ OECD (1999), *The OECD Review of Regulatory Reform in the United States*, preliminary edition, May 1999, p 17.

⁷ Winston, Clifford (1998), US Industry Adjustment to Economic Deregulation, *Journal of Economic Perspectives*, vol 12, no 3.

quality and price reductions. They also found that regulatory reform had generated gains for consumers and for society as a whole.⁸

.4 In Australia, the National Competition Council has observed that:

Competition contributes to achieving higher growth by helping to ensure that the community's resources – the physical environment, financial resources and people's skills and ideas – are used in the most valuable way. Accordingly, Australia's governments have taken the logical view that the disciplines imposed by effective competition, being the greatest drivers for improving productivity and encouraging innovation, need to be extended throughout all sectors of the economy...⁹

.5 Choice and competition can also deliver gains in the education sector. While the empirical evidence is not as extensive as in the economic sectors, there is nonetheless a growing body of empirical evidence identifying gains from competition at both the school and tertiary education levels. For example:

- Hoxby examined choice reforms in three US jurisdictions and found that, in each case, regular public schools increased educational achievement per dollar spent when exposed to competition;¹⁰
- Hoxby also examined the impact of Catholic schools (the main class of private schools in the United States) on public schools and found that public schools in areas with larger concentrations of Catholic schools performed better across a range of indicators;¹¹

⁸ Crandall, Robert and Jerry Ellig (1997) *Economic Deregulation and Customer Choice: Lessons for the Electricity Industry*, Center for Market Processes, Fairfax, Virginia.

⁹ National Competition Council (1997), *Competitive Neutrality Reform: Issues in Implementing Clause 3 of the Competition Principles Agreement*, AGPS, Canberra, p 1.

¹⁰ Hoxby, Caroline Minter (2001), *School Choice and School Productivity (or, could school choice be a tide that lifts all boats?)*, paper prepared for the Economics of School Choice Conference, National Bureau of Economic Research, Cambridge.

¹¹ Hoxby, Caroline Minter (1994), *Do Private Schools Provide Competition for Public Schools?* NBER Working Paper No. W4978, Cambridge.

- Hanushek and Rivkin provide some initial evidence that more competition tends to increase teacher quality, particularly for schools serving predominantly lower income students from lower income backgrounds;¹² and
- studies by Zanzig¹³, as well as Borland and Howsen¹⁴ found that increased competition among public school districts – in California and Kentucky respectively – enhanced student test scores.

.4 Lori L Taylor, who has written widely on school competition issues, summarised the evidence on competition as follows:

Most of the work on government responses to competition has focused on the market for education, and here the literature is strikingly consistent – competition improves public schools. Almost across the board, researchers have found that school spending is lower, academic outcomes are better, and school-district efficiency is higher where parents have more choice in their children's educational provider. Furthermore, competitive benefits emerge regardless of whether the competitor is a private school or another public school. Thus, the literature offers support for the notion that increased school competition – fostered either by vouchers or charter schools – would improve the public school system.¹⁵

.5 In commenting on Britain's experience under the Blair Government, Howard Glennerster of the London School of Economics has noted that, despite stagnating education spending, education outputs (ie outcomes) grew in a way "unseen in thirty years". According to Glennerster:

¹² Hanushek, Eric and Steven Rivkin (2001), *Does Public School Competition Affect Teacher Quality*, Paper prepared for the Economics of School Choice Conference, National Bureau of Economic Research, Cambridge.

¹³ Zanzig, Blair R (1997), 'Measuring the Impact of Competition in Local Government Education Markets on the Cognitive Achievements of Students', *Economics of Education Review* 16, pp 431–444.

¹⁴ Borland, Melvin V and Roy M Howsen (1992), 'Student Academic Achievement and the Degree of Market Concentration in Education', *Economics of Education Review* 11, pp 31–39; Borland, Melvin V. and Roy M Howsen (1993), 'On the Determination of the Critical Level of Market Concentration in Education', *Economics of Education Review* 12, pp 165–169; Borland, Melvin V and Roy M Howsen (1996), 'Competition, Expenditures and Student Performance in Mathematics: A Comment on Couch et al', *Public Choice*, 87, pp 395–400.

The reason seems to be that a degree of competition, devolved budgetary responsibility, the setting of national standards and required following of good practice produced results ... Head teachers now seem to strongly appreciate the degree of managerial freedom the devolved budgets have brought. The numeracy and literacy hours seem powerful ingredients. In short, it is doubtful if any one of these measures on their own would have produced the change. It would certainly be premature and retrograde to go back on any of them now.¹⁶

- .6 New Zealand's experience with competition at the school level, though often criticised, has been positive. The broadly 'market-based' New Zealand reforms have led to increased diversity of supply and choice for consumers, especially among those from low socio-economic groups, Maori and Pacific Peoples.¹⁷
- .7 While the rhetoric of the various Smithfield Project reports has generally been anti-choice and anti-competition, their results have actually revealed the opposite – that the introduction of competition has had a number of benefits. For example, the Smithfield reports showed that, after the abolition of zoning:
- Maori and Pacific Peoples made the greatest use of parental choice. The biggest increases in students not attending their nearest school was among these groups – fully 1/3 of them were not attending their nearest school after the abolition of zoning – versus 26 percent for Pakeha; and
 - income segregation in public schools fell after choice was introduced – contradicting the so-called 'polarisation' hypothesis. For example, the Smithfield work found that income segregation was lower in 1993 than in 1990, the final year of zoning.¹⁸

¹⁵ Taylor, Lori L (2000), The Evidence on Government Competition, *Economic and Financial Review*, Second Quarter 2000, Federal Reserve Bank of Dallas, Dallas, p 7.

¹⁶ Glennerster, Howard (2001), *United Kingdom Education 1997–2001*, London School of Economics, London, p 11.

¹⁷ LaRocque, Norman (2001), *Shaping the Tertiary Education System: An Assessment of the Second Report of the Tertiary Education Advisory Commission*, The Education Forum, Auckland, www.educationforum.org.nz

¹⁸ Mark Harrison (2001), 'Book Review, When Schools Compete: A Cautionary Tale' by Edward Fiske and Helen Ladd, *Education Matters*, Summer 2001, <http://www.edmatters.org> and Mark Harrison (1998), *Review of the Policy Recommendations from the Smithfield Project Reports*, report prepared for the Ministry of Education, Wellington.

- .4 Gorard and Fitz found similar results for England and Wales regarding the impact of 'market-based' policies on segregation. In the case of England, their research showed that the stratification of the school system along socio-economic lines decreased after the introduction of limited competition under the 1988 Education Reform Act.¹⁹
- .5 While the arguments in favour of competition are strong at the school level, they are even stronger at the tertiary education level. As Johnstone has argued, higher education satisfies many of the conditions of a private good, which makes it amenable to market allocation. In particular:
- higher education does not have the characteristics of a purely public good (ie non-rivalry, non-excludability); and
 - consumers of higher education are reasonably well informed and providers are often ill informed.²⁰
- .4 In a submission to the Review of Higher Education Financing and Policy (the West Committee) in Australia, the Australian Industry Commission supported a market-oriented approach to higher education on the grounds that it would:
- establish a strong customer-supplier relationship between students and institutions;
 - empower institutions to offer services at prices and in quantities and qualities that reflect their specific circumstances and the preferences of their students; and

¹⁹ Gorard, Stephen and John Fitz (1998), 'Under Starters Orders: the established market, the Cardiff study and the Smithfield project', *International Studies in the Sociology of Education*, vol 8, no 3, 1998.

²⁰ Johnstone D. Bruce *et al* (1998), *The Financing and Management of Higher Education: A Status Report on Worldwide Reforms*, The World Bank, Washington, DC, p 3.

- give institutions greater freedom in the types of courses they offered, including their prices and qualities, subject to government regulations relating to anti-competitive behaviour, course accreditation and related quality assurance.²¹
- .4 In the United Kingdom, the National Committee of Inquiry into Higher Education (the Dearing Committee) supported a move toward more demand-driven funding.²²
- .5 The United States, which has arguably the best higher education system in the world – in terms of quality, diversity and levels of participation, also has one of the most competitive higher education systems in the world. This includes a very strong private education sector – both for-profit and not-for-profit. According to *The Economist*, the competitive nature of the system is one of the key reasons for its success:
- The unique advantages of America's universities go beyond the hybrid vigour of a system in which state and private institutions have all been allowed to seek out their competitive advantage. Much of the system's success derives from the readiness of American academics to let market forces work. In contrast to most countries, where pay is centrally negotiated, competing American campuses strive to outbid one another for talent...²³
- .6 The Task Force on Higher Education and Society, in its report entitled *Higher Education in Developing Countries - Peril and Promise*, which actually argues for a stratified tertiary education structure, nonetheless supports competition. It argues that:

²¹ Industry Commission (1997), *Industry Commission Submission to the Review of Higher Education Financing and Policy*, AGPS, Canberra, p 22.

²² National Committee of Inquiry into Higher Education (1997), *Higher Education in the Learning Society*, Report of the National Committee of Inquiry into Higher Education, <http://www.leeds.ac.uk/educol/ncihe>, London.

²³ *The Economist* (1997), 'The Core and the Cloud', 4 October 1997, p S20.

[t]he Task Force believes that more intense competition between similar institutions for faculty, students and resources will help improve standards by rewarding merit and performance. Competition also generally promotes beneficial innovations and overall quality improvements. Competition is exceedingly difficult to achieve through central decree, but requires a high degree of autonomy for academic institutions, allowing them to exploit their strengths and overcome weaknesses.²⁴

- .7 In the end, TEAC and the TERB do not make the case that competition has had an adverse impact on the tertiary education sector in New Zealand. Despite the strength of its views, the Commission does not even make the case that the weaknesses it identifies are real and pervasive.
- .8 This is of concern since so much of the proposed approach is built on the assertion that an "excessive reliance" on competition has harmed the tertiary sector. It is important that real problems be linked to their real causes and that feasible alternatives are compared on a like for like basis. This is especially true given the overwhelming evidence from other sectors that competition is a good thing.
- .9 One of the hallmarks of the TEAC/TERB approach to funding and regulating the tertiary education sector is the desire for greater centralised 'steering' of the system. Under the TERB, this is to be effected through a system that includes the TEC, the Tertiary Education Strategy and institutional charters and profiles. While the funding mechanism is not spelled out in the TERB, the new system will introduce what TEAC described as a 'desirability' test to determine which courses/programmes ought to be offered and/or funded.
- .10 It is not clear that the proposed allocation mechanism will deliver a better or more 'strategic' allocation of resources than the current market-based system. Indeed, there are good reasons to believe that a centralised system will be inferior. This is because central planners have neither better information nor

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Task Force on Higher Education and Society (2000), *Higher Education in Developing Countries: Peril and Promise*, The World Bank, Washington, DC, pp 50–51.

better incentives than students and tertiary institutions to guide them in the difficult task of interpreting market signals as to which skills are in demand and hence which courses ought to be taught.

- .11 One of the key advantages of the market system is that it can better overcome the information problem. Central planning requires a great deal of quality, timely information if it is to be done well. Even in a country as small as New Zealand, information is costly or even impossible to obtain. The multi-dimensional nature of education means that the central planner must know what courses and programmes are in demand, when and where they are in demand, whether students would prefer to study full year, part-year, full-time, part-time or whether they want to study extramurally. They must also know the 'quality' of tuition that students desire, how much students are willing to trade off price for quality and whether students prefer an 'academic' or 'applied' treatment of a subject.
- .12 At the same time, the central planner must know which institutions would be best placed to deliver the courses and programmes in demand, what mode of delivery is best, and so on. As Mark Harrison has noted:

The advantage of competitive markets is that they make use of decentralised knowledge, as consumers know their preferences and producers know their own production functions. For example, students have better information than the central department on the effectiveness of teaching and consumption benefits associated with university life. In a market system, price signals provide information to producers on the value students place on different educational packages and provide the incentive for producers to respond to those preferences. The market coordinates the subjective judgements of suppliers and demanders. Whether higher quality is worth the extra costs is tested by whether consumers are willing to pay for the higher quality product.²⁵

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Harrison, Mark (1997), *Review of Tertiary Funding Arrangements and Options for Change*, report prepared for the New Zealand Treasury, The Treasury, Wellington, p 5.

- .13 The information challenges for the central planner are becoming more severe over time given technological developments, globalisation, changing demographics, the move to mass tertiary education and the increasing sophistication of consumers. The current decentralised system – where decisions regarding courses and programmes are made by students and tertiary institutions – is far more likely to produce the skills that the economy needs. It is also far more likely to be responsive to changes in demand and to respond to new opportunities – whether in the areas of information technology, biotechnology or mental health.
- .14 Nicholas Barr and Iain Crawford argue against central planning on the following basis:

Today... there are many more students, the training they require is much more diverse and it is changing ... [T]he task has become vastly too complex for central planning to be possible any longer ... [N]either is central planning desirable ... [s]tudents are more capable of making the necessary choices ... [a]nd will, in future, be capable of making more complex choices provided they have the necessary information ... [s]trong changes in demand will require universities to respond in ways which are wholly impossible within a centrally planned funding mechanism. Universities have to be free to decide the prices they charge, the types of courses and the number of places ... [S]tudent demand will be more attuned to continually evolving employer demand than central planning ever could. If the government wishes to influence outcomes (e.g., to encourage more students to study engineering), they would do so by providing financial incentives for relevant courses.²⁶

- .15 An additional concern is that decisions regarding funding allocations will be subject to government failure. Politicians and politically appointed boards such as the proposed TEC, even with adequate information, will not be making decisions in a vacuum. The political process may generate pressures to favour particular courses or programmes, institutions or regions over others. The

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Barr, Nicholas and Iain Crawford (1998), 'Funding Higher Education in an Age of Expansion', *Education Economics*, vol 6, no 1, p 48.

interests of producers, who are generally well organised and well financed, are likely to dominate the interests of consumers or other groups, whose power is diffuse. The recent controversy over funding of PTEs is a case in point.

- .16 A second concern with the proposed approach is the emphasis it places on ensuring that courses are in the 'national interest'. The notion of what is in the 'national interest' is extremely difficult to define and to put into practice. Determining which courses are in the 'national interest' involves, to some degree, 'picking winners'. This is an area where governments have typically shown little comparative advantage, as evidenced by the Think Big projects of the 1970s. The process of determining and identifying what is in the national interest is fraught with political danger and open to capture by well-organised interests.

- .17 There is a further risk that the Crown's ownership interest will dominate its purchase interest in the determination of what is in the national interest. Politicians and the TEC would find it difficult to resist pressure to use the funding allocation process to prop up poorly performing state tertiary institutions. While this is an issue now under the current system, it is likely to be much greater under a centralised system. The multiple roles and unclear objectives of the TEC would exacerbate this risk.

- .18 Once again, the question is whether students and tertiary institutions or the central bureaucracy have better information for making judgments as to which course or programme is the right one for the student. The informational advantages and better alignment of incentives suggest that students are better placed. Evidence from the United States suggests that students generally make good choices when it comes to the type of education or training they will undertake. They are able to perceive the fields where demand is strongest and take account of the costs of undertaking the education. Average student expectations about the rates of return to education are close to actual market

outcomes.²⁷ Heijke (1996) has noted that "[T]hese research results indicate that students apparently pay considerable attention to the labour market when they are deciding whether to study further, and that they are also able to form a general picture of their perspectives in the labour market ..."²⁸

- .19 The task of determining which programme areas will serve the 'national interest' is not an easy one for central planners. The experience in the teaching sector is salutary.²⁹ Mark Blaug argues that the best approach to labour market planning is to increase the flexibility of the educational system so that it can respond to forecasting errors.³⁰ If the problem is one of poor information regarding career choices, then it is appropriate to address that problem.³¹ To the extent that the TERB proposals introduce new rigidities into the tertiary education sector, they will act to worsen labour market planning.
- .20 As noted above, we have significant concerns with a 'centralist' approach to regulating the tertiary education sector. In our view, market mechanisms operating within a decentralised system are most likely to assist in meeting the government's objectives. The current system is not perfect by any means. However, a range of reforms aimed at supporting the operation of a decentralised system, including better quality assurance mechanisms, improvements to institutional governance and better information, would likely yield superior outcomes to what is being proposed in the TERB.
- .21 In the end, however, the degree to which the above criticisms apply will very much depend on the way the TERB proposals are implemented. In our view, a critical factor in determining the success or otherwise of the TERB will be the way it is implemented. This is because the powers in the TERB are broad and

²⁷ Harrison, Mark (1997), *op cit*, p 41. Harrison cites a number of further sources of evidence.

²⁸ Heijke, Hans (1996), *Labour Market Information for Educational Investments*, Working Paper, Research Centre for Education and the Labour Market, Maastricht, p 6.

²⁹ Scanlon, Sean, 'Staffing Crisis Looms as NZ Teachers Snap up Work Overseas', *The Press*, 5 January 2001 and Kristin Rushowy, 'Qualified Substitute Teachers in Short Supply', *The Toronto Star*, 11 December 2000.

³⁰ Blaug, Mark (1970), *An Introduction to the Economics of Education*, Penguin.

³¹ Harrison, Mark (1997), *op cit*, p 41.

enabling, rather than prescriptive. It will give the minister and the TEC considerable leeway in how their new powers are used.

- 4.39 To the extent that the various regulatory instruments such as the TES, the TEC and charters and profiles are used to micro-manage the sector, they will introduce rigidities into the system and weaken market signals – the primary means of information dissemination in the sector. Rather than add value, such an approach would give rise to considerable institutional 'gaming' of the system, increased red tape, higher costs and a lengthening of the 'time to market' for new courses and programmes. In the end, a heavy-handed regulatory approach would be likely to frustrate, rather than promote, the achievement of government objectives.
- 4.40 In our view, the only way that the TERB approach will generate net benefits to the country is if it is implemented in a 'light-handed' manner (as recommended by the Working Party on Charters and Profiles³²), with the government and the TEC focussing predominantly on information provision and performance measurement. Implementation in this way would provide greater scope for the new regulatory instruments to strengthen, rather than supplant, market mechanisms. Even with that, the danger of a heavy-handed system remains if the legislation is passed as is.
- 4.41 While we believe that an alternative policy direction to that outlined in the TERB would be the best way to go, we also believe that the TERB could be improved in a number of ways. We would recommend:
- limiting the scope for arbitrary decision making by introducing decision-making criteria to guide both ministerial and TEC decisions (eg funding decisions under s 159, course approvals under s 258, accreditation conditions under s 259, etc). Currently, these sections are not specific as to

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Working Party on Charters and Profiles (2001), *Report of the Working Party on Charters and Profiles*, Government of New Zealand, Wellington, p 6.

what factors ought to be taken into account when making decisions regarding funding, approvals, accreditation, etc. The TERB would appear to be far less specific about the funding system than is the current legislation;

- ensuring that the criteria used in determining funding allocations (at an institutional, sub-sector or sector wide level) under s 159, course approvals under s 258, accreditation conditions under s 259, etc are based on well-founded public policy criteria such as nature of output, cost, quality and performance; and
- strengthening legislative requirements for participation by, and consultation with, stakeholders, including business and enterprise.

4.42 We would commend the BusinessNZ submission to the Committee as it provides detailed drafting suggestions to achieve these ends.

4.43 Introducing the above safeguards would help to ensure that decisions regarding funding, approvals or accreditation did not reflect 'extraneous' factors such as the ownership status or the corporate structure of an institution, unless these were of relevance to the decision. There is a very real risk that such factors could play a significant role in decisions in the current environment – witness the recent funding moratorium on PTEs, as well as policy decisions on financial assistance to students at private teacher training colleges, private school funding caps, distinctions being drawn between for-profit and not-for-profit early childhood centres and attempts to coax ITOs into using state institutions rather than private ones.

4.44 We would also recommend that, where the TEC does attempt to guide the nature of provision in the sector, it does so via the setting of subsidy rates, rather than through the use of quantity limits based on charters and profiles. Thus, any move to encourage growth in specific areas should be carried out by altering subsidy levels and then allowing market mechanisms to determine provision. In

our view, control via charters and profiles would require far too much information. In particular, there are significant risks that the charters and profiles process could be used to favour particular types of provider over others, for no good public policy reason.

4.45 In addition, the government could consider making the TEC a more autonomous body, free of any potential for political or other interference. There is a significant risk of this happening in the current environment. The TEC could be guided by government priorities and fiscal constraints.

4.46 The TERB allows the government to impose a training levy on the members of an industry, payable to an ITO, if there is sufficient support for the imposition of that levy following a ballot of those members.

4.47 We are opposed to industry levies. In our view, the case for them is weak. The justification offered for levies often rests on the proposition that employers 'free-ride' on the training investments made by other employers. This is said to occur because the returns from training accrue after the costs of training are incurred. However, such concerns are overstated. There are two reasons for this:

- more than 50 percent of the up-front costs of training is paid for by the government; and
- the relatively flexible contracting that exists under the Employment Relations Act allows employers to protect their investment through various contracting mechanisms such as bonds.

4.48 Levies can also impose a range of economic costs on employers. These are costs similar to those incurred with general taxes, effects on employment relationships and the work/learning environment, and incentives for lobbying to acquire or retain levy powers. Levies could also reduce the responsiveness of ITOs to the

needs of employers and trainees. Incentives to serve their members wane considerably once survival does not depend on attracting members or clients.

4.49 We recommend that the relevant sections of the TERB relating to levies be abandoned. If, however, the government wishes to retain these sections in the TERB, we would recommend that ITOs be required to meet a very high threshold in making the case that a levy should be imposed. This would include providing evidence to justify its imposition, and an assessment of costs and benefits (eg a regulatory impact statement).

4.50 As currently drafted, the TERB does not appear to require either of these, with most of the focus being placed on the ballot as the mechanism for determining the 'need' for a levy. This contrasts with similar legislation such as the Commodity Levies Act 1990, which requires, *inter alia*, the applicant to show either:

- that it would be impossible or impracticable to finance the doing out of voluntary levies of the things for which the levy is to be spent; or
- that the doing of the things for which the levy is to be spent were paid for out of voluntary levies, persons who chose not to pay those levies would derive unearned benefits from the doing of those things.³³

4.51 In short, we believe that the imposition of such a levy should be subject to a desirability test, as well as a ballot.

4.52 We also believe that the ballot threshold should be set much higher than is currently proposed. As currently drafted, a levy could be imposed if only 36 percent of the industry agrees. While this may not happen that often in practice, it remains a possibility. This threshold appears to be much lower than that required under similar legislation such as the Commodity Levies Act 1990,

³³ See Commodity Levies Act 1990, s 4.

which seems to require that "considerably more than half" of all producers (or whatever measure is used) to support it, not just those who voted.

5.0 Conclusion

- 5.1 The Learning for Life and subsequent reforms ushered in a new era for tertiary education in New Zealand. The new funding system, the introduction of fees, the expansion of the private education sector, the student loan scheme and the self-managing nature of tertiary institutions have changed the face of the tertiary sector. These changes have, by and large, been for the better. Participation is up significantly and the sector is far more diverse than in the late 1980s. These gains have been broad-based, with Maori the greatest beneficiaries in terms of increased participation.
- 5.2 Despite this progress, the tertiary education sector in New Zealand faces a number of significant challenges, including changing demographics, changes in the world of work, changing labour market skill needs and rapid technological advancement.³⁴ These can't be stopped. It is therefore imperative that the tertiary sector be able to meet these challenges and deliver the skills that New Zealand needs to compete in the knowledge society. Few would argue that it is.
- .4 The second TEAC Report set out, and the TERB proposes to put in place, a more centralist regulatory framework that its framers believe offers a prescription for meeting these challenges. This submission has highlighted some of the strengths and weaknesses of the proposed approach.
- .5 We have considerable reservations that central 'steering' will deliver better outcomes than could be realised under a more decentralised system. The previous system was not perfect by any means. However, a range of reforms aimed at supporting the operation of a decentralised system, including better quality assurance mechanisms, improvements to institutional governance and

better information, would likely yield superior outcomes to what is being proposed in the TERB.

- .6 The success or otherwise of the TERB proposals will depend on the way it is implemented.
- .7 To the extent that the various regulatory instruments such as the TES, the TEC and charters and profiles are used to micro-manage the sector, they will introduce rigidities into the system, weaken market signals and frustrate, rather than promote, the achievement of government objectives.
- .8 In our view, the only way that the TERB approach will generate net benefits to the country is if it is implemented in a 'light-handed' manner, with the government and the TEC focussing predominantly on information provision and performance measurement.
- .9 While we believe that an alternative policy direction to that outlined in the TERB would be preferred, we also believe that the TERB could be improved in a number of ways. These include making changes aimed at reducing the scope for arbitrary decision-making, ensuring that the assessment criteria are based on well-founded public policy criteria and ensuring participation by, and consultation with, stakeholders, including business and enterprise.
- .10 Whether the TERB goes ahead or not, a range of wider, more fundamental tertiary education reforms should be considered, including:
 - eliminating the fee-stabilisation programme, which effectively caps student fees and starves the sector of needed revenues;

³⁴ See LaRocque, Norman and Jonathan Kaye (2001), *The Times They Are A-Changin': Polytechnics and the New Tertiary Environment*, report prepared for the Association of Polytechnics in New Zealand, Wellington, November 2001.

- revamping tertiary institution governance arrangements. Weaknesses in governance arrangements have been highlighted by a number of groups, including TEAC;³⁵
- ensuring neutral treatment for public and private providers in terms of funding and regulation;
- a reversal of recent reforms in the area of student finance, as recommended by TEAC, with a view to restoring the student loan scheme to its pre-December 1999 status;
- addressing quality concerns via strengthened accreditation and, in particular, making greater use of private accreditation as exists in other jurisdictions;³⁶ and
- splitting some proportion of funding into separate research and tuition funding and a continued targeting of research funding toward centres of excellence, whether applied or base research. We support recent government moves in that area.

5.10 We need to be realistic about what we can expect from the tertiary sector. While many observers would argue there is considerable scope for improving the sector's alignment with the country's broader needs, it is also true that no system will ever be perfect. Decentralised systems will have flaws. Equally, centrally 'planned' systems will have flaws. It is therefore important to be realistic about the limitations of both market-based systems and centrally driven systems.

³⁵ See for example The Treasury (1996), *Briefing to the Incoming Government*, The Treasury, Wellington; Scott, Graham and Simon Smelt (1995), *Ownership of Universities*, paper prepared for consideration by the New Zealand Vice Chancellors' Committee, Graham Scott New Zealand Ltd, Wellington, and TEAC (2001), *Shaping the Funding Framework: Fourth Report of the Tertiary Education Advisory Commission*, Wellington, pp 138–140.

³⁶ Working Party on Charters and Profiles (2001), *op cit*, p 17 and LaRocque, Norman (2001), *Regulating the Education Sector in Developing Countries, Part I*, presentation to the Adam Smith Institute Training Course *The Changing Role of Government in Education*, Sopwell House Hotel, St Albans, United Kingdom, 2–4 May.

- 5.11 The relevant question for policy-makers is not 'which system is perfect?' The relevant question for them is 'which feasible system is the best?' In the end, this must be the test applied when assessing the different options for funding and regulating the tertiary education sector.