

The Broken University

*What is seen and what is not seen in
the UK higher education sector*

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Executive Summary

While much of the current national debate on higher education has focused on what is seen – the immediate benefits of government spending and national planning – it has tended to neglect *what is not seen*, which are the hidden costs and unintended consequences of these interventions that have accumulated over time.

Findings

Firstly, there is no evidence that there is any economic benefit whatsoever from transferring over £14.3 billion a year from the taxpayer (including those on low incomes) to students and universities. Nor, secondly, is there any evidence to show that the public benefits associated with spending £14.3 billion on higher education will be either higher or better than the public benefits associated with taxpayers spending £14.3 billion in the local community. Thirdly, while many are convinced that the subsidy is helping to create a more equal and just society, it is impossible to escape the fact that part of this subsidy represents a transfer of wealth from those on lower incomes to those who will soon be on higher incomes. In short, the government is taxing the poor to help the rich get richer.

Furthermore, government intervention has also resulted in a significant number of hidden costs and unintended consequences, which include the following:

- Undermining the autonomy and independence of private institutions
- Crowding out philanthropic donations
- The complete disruption and distortion of the pricing system
- Combining and confusing academic, professional and vocational education
- The widespread rationing of university places
- Restricting private investment from home and abroad
- Crowding out for-profit institutions and entrepreneurial talent
- Restricting competition and innovation throughout the sector
- Qualification inflation

Conclusion

After taking into account the costs and consequences of government intervention outlined above, it is clear that not only is the £14.3 billion public subsidy to higher education not providing any economic or public benefit, and not only is it transferring income and resources from low income families to families with higher incomes, but it is also disrupting, distorting and preventing the growth and development of one of the UK's most important service sectors. In short, the government's annual £14.3 billion higher education subsidy is doing much more harm than good. It can therefore be readily compared to those government subsidies which over the previous half-century supported a variety of national champions, and which also resulted in the exact opposite of their original intention.

Policy Recommendations

Policy recommendations include:

- Establishing a new, limited role for government
- Abolishing the cap on tuition fees
- Establishing full freedom of entry into the higher education sector
- Extending charitable tax benefits to for-profit institutions
- In the short term, re-directing subsidies from institutions to students
- In the long term, phasing out subsidies altogether
- Encouraging privately funded research and development

1 Introduction

The French political economist Frédéric Bastiat (1801–1850) noted that the task of examining public policy was complicated by the fact that government interventions often produced not just one immediate and visible effect, but also a series of hidden costs and unintended consequences which accumulate over time.¹ He used the parable of “The Broken Window”, which begins when a boy accidentally smashes the window of a baker’s shop. The baker subsequently contacts the local glazier who replaces the window and is paid for his services. After covering his costs, the glazier then spends the rest of his money in the local community, generating further income for the butcher, tailor and innkeeper, who also then spend their extra income elsewhere, and so on. After the window had been broken a crowd of onlookers appeared at the scene. Although they had sympathy for the baker, they concluded that the breaking of the window would have a positive effect on the local economy. After all, what would happen to the glazing industry if no one broke any windows? Based upon this assumption they also concluded that the breaking of more windows would help to generate further growth and prosperity.

1 Bastiat’s collected works have recently been republished by the Mises Institute (www.mises.org) in the US and can be downloaded for free or a hard copy purchased online for \$44.

According to Bastiat this interpretation fails to take into account *what is not seen*. For example, before the window was broken the baker was planning to buy a new pair of shoes. Therefore, while the glazier may have benefited, this was at the expense of the shoemaker. The economic growth caused by the glazier spending his money in the local economy would have occurred anyway. It doesn't represent any additional growth; simply a transfer of income from the shoemaker to the baker. *What is also not seen* is that instead of fitting a new window into a new house, the glazier's efforts have now been redirected towards replacing the broken window. Finally, despite spending some of his money, the baker is left with just a window and has been denied the satisfaction of a new pair of shoes. The baker is clearly worse off. As he is part of the local community, it soon becomes clear that the breaking of the window was not good for that community after all.

The importance of recognising *what is not seen* in public policy is encapsulated in the law of unintended consequences, which acknowledges that the actions of individuals, organizations and governments will always have some unintended consequences (both positive and negative). Even when government policies achieve their stated goals in the short run, they may still be doing more harm than good in the long run, after the hidden costs and unintended consequences have been taken into account. A devastating example was when Chairman Mao had the bright idea of ordering everybody to kill sparrows in order to prevent them from eating the rice. Unfortunately, the killing of millions of sparrows led to an explosion in the insect population, which then proceeded to eat all of the rice, plus all the other crops. The result was mass starvation. Chairman Mao had failed to take into account *what was not seen*, which was the impact of his intervention on the insect population.

Identifying *what is not seen* in public policy is also the subject of a 2009 Office of Fair Trading report, *Government in Markets*, which suggests that ‘[o]ne of the biggest challenges for policy makers is to identify unintended consequences of regulations’ and to minimise their potential impact when designing new legislation.² As noted by John Fingleton (Chief Executive, OFT), what makes the policy making process so difficult is the fact that these ‘damage to competitive markets is often initially hidden, only becoming obvious over time and can be extremely difficult to remove or reverse’.³

Looking at *what is not seen* is an approach that was used to great effect by Levitt & Dubner in their 2005 bestseller *Freakonomics*, which attempted to reveal what the authors described as ‘the hidden side of everything’. Their book was based on a number of ideas, including the suggestions that conventional wisdom is often shoddily formed and devilishly difficult to see through, that experts often use their informational advantage to serve their own agenda, and finally that incentives matter. Each of these ideas also plays a key role in helping to identify and understand *what is seen* and *what is not seen* in the UK higher education sector. In this confusing world, the reader is advised to follow Levitt & Dubner’s advice: “ASSUME NOTHING – QUESTION EVERYTHING”.

While much of the current national debate on higher education has focused on *what is seen* – the immediate benefits of government spending and national planning – it has tended to neglect *what is not seen*, namely the hidden costs and unintended consequences of these interventions which have accumulated over time. This report therefore aims to shed light on some of these hidden costs

2 *Government in Markets: Why Competition Matters – A Guide for Policy Makers*, OFT, 2009, p.23.

3 Speech by John Fingleton (Chief Executive, OFT) to the Regulatory Policy Institute, Oxford, 7 September 2009.

and unintended consequences in the hope that it will help to inform the ongoing national debate on what a world-class higher education system should look like.

2 What is seen in higher education

There are currently 169 publicly funded higher education institutions in the UK, with 109 recognised as universities.⁴ Four are ranked among the top ten in the world, with a further five ranked in the top fifty. Despite the UK only having 1% percent of the world's population, its universities produce 7.9% of the world's research publications and 12% of all citations. This is second only to the US. The fact that the UK is now the second largest destination (after the US) for overseas students, confirms that the UK has a world-class reputation in higher education.

Previous government legislation and public investment in higher education has received widespread support from across the political spectrum. This is because of the remarkable benefits that higher education promises to bring. For example, Universities UK estimates that those who graduate from university with a degree will earn approximately £160,000 more over the course of their working lives than those with two A levels. Graduates have also been found to be less likely to smoke or become obese, and also exhibit lower levels of depression. On top of these private benefits,

⁴ *Higher Education in Facts and Figures*, Summer 2008, Universities UK.

higher education also promises to deliver substantial public benefits including increased tax revenues, reduced crime rates, an increase in charitable giving and community service, more social cohesion, and a decreased reliance on government support. Universities are recognised as being important economic assets in themselves, with the sector's economic output now estimated to be over £59 billion a year; an increase of £10 billion since 2004. Universities also directly provide over 314,600 full time equivalent jobs, and over 353,900 additional jobs are generated throughout the economy through secondary effects. In total this represents approximately 2.6% of full time employment in the UK.⁵

According to the Higher Education Funding Council of England (HEFCE), universities in the UK have never been more important because they 'unlock the talents of students; promote shared values; extend opportunities to an increasingly wide range of people; drive local and national economic growth; provide a highly skilled workforce; create innovative world beating products and services; create jobs; and support communities'. HEFCE is therefore confident in concluding that '[w]e have a world class higher education system, delivered through autonomous universities and colleges responding to market and policy incentives in ways that fit their mission, location and aspirations'.⁶ This view is supported by Professor Steve Smith (President, Universities UK), who in September 2009 described UK universities as 'unquestionably one of the UK's outstanding international successes'. According to Professor Smith, the nation's future now depends on a successful university sector. Only universities can provide a route to that future 'since they are

5 *The Impact of Universities on the UK Economy: Fourth Report*, Universities UK, 2009 (2007 statistics).

6 *Understanding Institutional Performance, Advice to the Secretary of State for Innovation, Universities and Skills*, HEFCE, 2008, p.3.

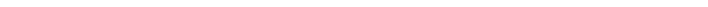
the most effective ways to promote social mobility, to ensure social cohesion and to create both the jobs for the future and a work force with the skills that the knowledge economy requires⁷.

After widespread consultation, the government published its national plan *Higher Ambitions* in November 2009, which outlines how universities will be expected to change and adapt to meet all future challenges and maintain their world-class status. Despite the success of the UK's higher education sector, complacency is not an option and a number of outstanding issues still need to be addressed. These include how to improve access to students from low income families, what to do with the cap on tuition fees, how to increase private and philanthropic investment, and how to ensure that courses remain relevant to the world of work.

This very brief account of the state of higher education in the UK represents (more or less) the prevailing consensus, and is based entirely upon *what is seen*.

7 Keynote speech by Professor Steve Smith (President, Universities UK) to Members' Annual Conference, Edinburgh University, 10 September 2009.

3 What is not seen in higher education



3.1 Why the £14.3 billion annual subsidy?

According to the prevailing consensus, higher education and economic growth are closely linked, so increasing public subsidies to higher education will help to increase wealth and prosperity for all. Together with the numerous benefits enjoyed by each individual graduate, higher education also promises to deliver substantial public benefits. According to Professor Nicolas Barr (LSE), this provides ‘a cast iron case for taxpayer support’.⁸ It has also been suggested that in an economic downturn the government can help to stimulate economic growth by increasing public investment in higher education. According to Professor Smith, this is not special interest pleading for more public subsidies but rather ‘an evidence-based, logically constructed argument’.⁹ This is *what is seen*.

However, *what is not seen* is that there are many activities which are closely linked to economic growth, and there are many individual activities which also benefit the wider community. But this alone

8 Professor Nicolas Barr, Higher Education Policy Institute seminar on ‘The Operation of the Market in Higher Education: Opportunities and Constraints, Experience and Ideology’, held at the British Academy on 14 January 2009.

9 Keynote speech by Professor Steve Smith (President, Universities UK) to Members’ Annual Conference, Edinburgh University, 10 September 2009.

is not a sufficient reason to justify forcing other members of the public to subsidise them. If taxpayers were expected to subsidise everything that was useful, where would it end? In Bastiat's story of the broken window, the crowd of onlookers appeared on the scene after the window had been broken. They were therefore inclined only to take into account *what was seen* – the benefits which accrued to the glazier and the rest of the community following the accident. In the story of the broken university, economists have also appeared on the scene after the government had started to subsidise higher education and as a result they too have tended to focus on *what is seen*, which are the expected benefits captured by each individual student and the wider public.

For example, in a 2006 report published by Universities UK, universities are described as 'independent business entities' with an income of £16.9 billion.¹⁰ This was found to be generating £45.1 billion of UK industry output (in 2003/04) and providing over 280,000 jobs directly, with an additional 301,000 being generated throughout the economy. The report concludes: '[i]t is evident from the findings of this report that such [public] investment has a direct economic impact on the UK economy'.¹¹ In the follow up report published in 2009, the income or 'total revenue earned' by universities in 2007/08 was found to be £23.4 billion, £14.3 billion (or 61 percent) of which came from 'UK public sources'. That generated over £59 billion of 'output', therefore confirming 'a rapid growth in economic impact'.¹² Direct employment had also

10 In a speech on 24 February 2009, the Secretary of State John Denham stated that '(u)niversities and colleges themselves are successful businesses locally and globally and are often large employers. . . Indeed, other sectors might learn from the success of higher education as a business!'

11 *The Economic Impact of UK Higher Education Institutions*, University of Strathclyde, Universities UK, March 2006, p.3.

12 This report was produced for Universities UK by Ursula Kelly, Donald McLellan and Emeritus Professor Iain McNicoll of the University of Strathclyde.

increased to over 314,600, with an additional 353,900 jobs being generated throughout the economy, representing approximately 2.6% of full time employment in the UK. The economic activity generated by university expenditure is also described as 'substantial' and 'very important at the macroeconomic level', which is comparable to legal services and larger than the pharmaceutical and aircraft industries in the UK. According to Professor Smith, these figures show that the higher education sector is 'one of the UK's most valuable industries', and unquestionably 'an outstanding success story for the economy'.¹³ This is *what is seen*.

However, *what is not seen* is that if public policies are examined only from the point at which public funds are spent, everybody seems to benefit. For example, when a government spends £14.3 billion for whatever reason, those receiving these funds are clearly going to benefit by some degree. Experts are then tasked with attempting to measure or guess how much everyone benefits by this additional spending and this is identified as a positive gain or an addition to the national income.

What is not seen is that because the government makes no money of its own, for every £1 it spends it must first remove at least £1 from the taxpayer's wallet. Therefore, when the government spends £14.3 billion on higher education, taxpayers are forced to spend at least £14.3 billion less in their local community.¹⁴ While the Universities UK report gives the impression that the £14.3 billion spent on higher education, and the resultant economic activity, represents an addition to the national income,

13 Universities UK Media Release, 4 November 2009.

14 If the government spends £14.3 billion on higher education then it must first take £14.3 billion from the taxpayer, plus the additional amount it costs to collect and then redistribute these funds. Any additional deadweight costs of taxation would also have to be taken into account.

it fails to recognise that it actually only represents a transfer or a relocation of resources. While it may be obvious that universities, students and the community are going to benefit from a £14.3 billion subsidy, it should be equally obvious that the taxpayer and the community will also be £14.3 billion worse off. It is therefore meaningless to claim that £14.3 billion public investment in higher education has had ‘a direct economic impact on the UK economy’ or that its impact has been ‘substantial’ and ‘very important at the macroeconomic level’, without also acknowledging that removing £14.3 billion from taxpayers’ wallets will also have a substantial economic impact on the UK economy. As it is impossible to predict if more economic growth will be generated if the £14.3 billion is spent by the taxpayer in the local community, or if it is spent on higher education, then there is no evidence to show that there will be any economic benefit from the annual £14.3 billion subsidy to higher education.¹⁵

The problem of focusing only on *what is seen* can be further highlighted by imagining what would happen if the government decided to increase the public subsidy from £14.3 billion to £100 billion. We can only assume that Universities UK would publish a new report showing a dramatic increase in ‘earned income’ with campuses being rebuilt and the number of staff and their salaries doubling throughout the sector. As a result, higher education would now be identified as the UK’s largest service sector and an example of international best practice, with the government boasting that it now ‘invests’ more in higher education than any other country. However, such claims fail to take into account where the £100 billion has come from, the good that has been prevented, and the damage that has been caused

15 This is why Bastiat concluded that ‘a presumption of economic benefit is never appropriate for expenditures made by way of taxation’.

by making this transfer. As argued by Bastiat: '[o]n what basis do you dare to affirm that this official expenditure is an addition to the national industry? Do you not see that it is only a simple *transfer* of consumption and of labour? A cabinet minister has his table more lavishly set, it is true; but a farmer has his field less well drained, and this is just as true'.¹⁶

Even if experts could provide the necessary evidence to prove that transferring money from the taxpayer to the local university creates more wealth than simply leaving it where it is, taxpayers would still be justified in questioning the ongoing obsession with wealth creation and economic growth. For example, what if the taxpayer was intending to donate the money to the NSPCC instead, to help prevent cruelty to children. What if the taxpayer believes that preventing cruelty to children is more important than economic growth? Whose needs and interests should take priority?

The so-called 'cast iron case' for government subsidies is based on the assumption that the subsidy will not only benefit the individual student, but the wider community as well. The suggestion is that when students invest in their own university education they not only benefit themselves, but also the wider public, without intending or knowing about it. Likewise, the unsuspecting public do not know that they are benefiting from the students' actions and they don't expect or demand to receive such benefits. The self-interested acts of students therefore produce substantial public benefits, apparently confirming the existence of Adam Smith's invisible hand. However, under the prevailing consensus, higher education is now given as an example of market failure, which poses a serious threat to all future social and economic development. Accordingly, because students are driven by self-interest, they are accused of

¹⁶ Bastiat, *Selected Essays in Political Economy*, 1848.

failing to take into account the needs of the wider public. As a result they fail to invest enough in their own higher education and so insufficient public benefits are produced.

However, while the problem appears to lie with selfish students, the prevailing consensus also claims that the cost of solving the problem must fall upon the public, who are now forced to subsidise students. The public are therefore penalised, despite the fact that they have not demanded these benefits and have no idea what they are or that they are even receiving them. In fact, it would appear that neither the people who produce these benefits, nor the people who receive them know what these benefits are!

Assuming that each income taxpayer in the UK is currently paying approximately £400 a year to help subsidise higher education, the prevailing consensus amounts to this: by taking £400 out of each taxpayer's pocket and transferring it to universities and students, the government will make each income taxpayer and the wider community better off.¹⁷ Taxpayers should therefore be happy to be taxed, because the spending of these taxes will help to contribute to their employment.¹⁸

What is not seen is that if the taxpayer had been left to spend his £400 himself, this spending would also have benefitted both the taxpayer and the wider community. For example, prior to being taxed £400, the taxpayer was going to spend £200 on a new suit and donate £200 to the NSPCC to help prevent cruelty to children. Therefore, without government intervention the taxpayer benefits

17 In the government's 2003 White Paper (*The Future of Higher Education*) it states that government funding will increase to around £10 billion a year by 2005–06, 'which is equivalent to around £400 a year paid by every income tax payer in England, whether or not they personally gained from a university education'.

18 Or in Bastiat's more emotive language, those being robbed should be happy to be robbed because the product of the theft will contribute to their employment.

from having a new suit, the local tailor gets paid £200 and the NSPCC gets a donation of £200. However, after government intervention, the taxpayer is now denied the satisfaction of having a new suit and both the local tailor and the NSPCC have each been denied £200 of additional income. Therefore, when a taxpayer pays £400 in taxes and receives nothing in return, it clearly constitutes a loss. While it is claimed that the taxpayer will benefit indirectly from his so-called £400 investment, *what is not seen* is that the taxpayer would still enjoy the indirect benefits of higher education if students funded themselves.

Let's say that prior to receiving a government subsidy of £400, the student was going to invest £400 of his own (via student loans) or his parent's money in higher education. The student would still graduate from university and the taxpayer and wider community would still enjoy all of the public benefits that are said to come from university education. However, this time it would not be at the expense of the taxpayer, the tailor and the NSPCC, who still benefit from the taxpayer spending his £400. While the student would clearly be £400 better off if the government did intervene, this only represents a transfer of income from those who have earned it to those who have no real right to it.

While some may try to claim that the £400 will benefit the taxpayer and the wider community more if it is spent on higher education than if the taxpayer spent it himself, their ability to provide any evidence to support this claim is clearly restricted. Firstly, it is impossible to know what each individual taxpayer was going to spend his £400 on if he was not taxed. Nor is it possible to determine how much each taxpayer and community would have benefited from this spending. Secondly, it is difficult to know exactly what each individual taxpayer's £400 is going to be spent on in

higher education, as each £400 has the potential to be spent on a multitude of different things.¹⁹ The public benefits that come from each different £400 could diverge radically. And if we don't know and cannot measure the public benefits that are linked to the £14.3 billion public subsidy to higher education, then surely it is impossible to claim that these benefits are greater or better than those which would have occurred if the money was left with the taxpayer? In short, as the public benefit argument is based only on *what is seen*, it leads to conclusions that are not valid.

Finally, it is important to note that all of the confusion surrounding higher education and its impact on economic growth has only come about because of the government subsidy and the subsequent need for politicians and economists to try to justify it.²⁰ This confusion itself can be described as yet another hidden cost or unintended consequence of government intervention. It is remarkable how quickly questions considering the relationship between investment in higher education and economic growth, become irrelevant when applied to fully private institutions such as Buckingham University or BPP College. For example, if a student invests £10,000 a year to gain a qualification from one of these institutions, will this have a positive impact on economic growth? The honest answer has to be that maybe it will and maybe it won't. As this is a private investment which could have been made for a variety of different reasons, the value of the service received will be

19 For example, in 2008 the £400 from 350,000 income taxpayers was spent by universities on complying with the government's regulatory demands. It is therefore difficult to see how this makes a greater contribution to the local community than if the £400 had been spent by the income taxpayer himself. Some income tax payers will also end up contributing £400 to the salaries of economists, whose primary role is to justify to the taxpayer why they should be handing the £400 over in the first place!

20 For Bastiat, it was deplorable that the act of plunder, when aided and abetted by the law, eventually became a learned doctrine with its own professors, whose intellectual faculties were devoted to finding excuses for plunder in its remote and indirect consequences.

entirely subjective and decided by each individual student over a period of time. The personal opinions of politicians, civil servants and experts are irrelevant.

Subsidising university-based research

The promise of wealth and abundance for all is also increasingly being used to justify subsidising university-based research, which in 2007/8 amounted to £3.4 billion; an increase from £1.3 billion in 1997. According to a 2007 report published by Research Councils UK, the conventional rationale for public funding of R&D relates to market failures which occur because of the ‘likelihood that investors in R&D are unable to appropriate all the benefits which society might derive from research outputs’. This is confidently referred to as a ‘well established and robust rationale for much of the Research Councils’ activities’.²¹ Therefore, according to the prevailing consensus, when a business invests in research and development, this not only benefits the business concerned but also benefits other businesses and the wider public. However, businesses are accused of failing to invest enough in R&D, and thus producing insufficient public benefits. This allegedly threatens future social and economic development. According to the government this problem can only be solved by taxing all businesses to help fund research, which will be carried out by university-based academics. This is *what is seen*.

However, *what is not seen* is that there are an endless number of reasons why each of the 2.15 million enterprises registered for VAT and/or PAYE in 2009 may or may not choose to invest in R&D,

²¹ *Study on the economic impact of the Research Councils, PART I: Summary*, Research Councils UK, October 2007, p.24.

many of which will have nothing to do with the reason outlined above.²² As the circumstances of each individual organization will be different and continuously changing, it is clearly problematic to generalise. The 'well-established and robust rationale' above also appears to contradict the experience of those companies that continue to invest in R&D, despite the fact that they may be unable to capture all of the wider social benefits.²³ As previously noted by Kealey,²⁴ R&D is commercially profitable 'not because firms expect to capture all of the returns to their effort, but rather because they can appropriate enough of them to make their investments worthwhile'.²⁵ The fact that companies spend approximately £39 billion a year on employee training, also suggests that companies are more than willing to invest in the future, even though there is no guarantee of capturing all of the benefits.²⁶

Furthermore, it is difficult to discuss or criticise levels of private investment in R&D without first taking into account the current rates of business taxation, which will clearly have some influence on the levels of private investment. The current rate of corporation tax in the UK is 28%, and in 2007 the receipts from this tax alone were approximately £46 billion. While the rate of corporation tax has been declining over the years (from 33% in 1993), the income

- 22 For example, a business may decide that instead of investing in R&D, they will benefit much more by introducing an above inflation pay increase to help reward and further motivate employees. Or a business may decide to upgrade its IT hardware and software, or the owner of a medium sized business may have decided to invest £100,000 in R&D one day, only to change his mind and purchase a luxury sports car for £100,000 the next.
- 23 R&D is a key expenditure in many sectors. UK aerospace, automobiles, pharmaceuticals and software and technology firms invested substantially more in R&D than they earned as profits'.
- 24 For a detailed analysis of what is seen and what is not seen with reference to the public funding of science and R&D see Kealey 's *The Economic Laws of Scientific Research* (1996) and *Sex, Science and Profits* (2008).
- 25 Terence Kealey, *The Economic Laws of Scientific Research*, 1996.
- 26 *Key Facts 1*, CBI HE Task Force, September 2008.

generated from corporation tax increased rapidly between 1997 and 2007. Therefore, while the government may be happy to boast about its record of increasing the amount of public investment in R&D from £1.3 billion in 1997 to £3.4 billion in 2007/8, *what is not seen* is that during the same period the revenues the government received from corporation tax alone increased from approximately £30 to £45 billion.²⁷

What is also not seen is that according to the CBI, corporation tax is only one of 22 business taxes and so for every £1 of corporation tax paid, companies pay an additional £1 in the various other taxes. This suggests that the total corporate tax burden in 2007 was over £90 billion. While the UK's corporate tax rate used to be a competitive advantage, large reductions in tax rates in competitor economies have started to erode the UK's position, which makes the total tax burden on UK business relatively high. This is confirmed by PricewaterhouseCoopers whose 2008 Total Tax Contribution (TTC) of the UK's largest companies found that the UK had the highest average Total Tax Rate (TTR), apart from the US and Belgium.²⁸ The CBI report concludes by warning that an uncompetitive tax system will not only erode the competitiveness of businesses, but it also risks driving economic activity abroad. Therefore, unless the increasing tax burden is tackled, the 'competitiveness of UK-based businesses will continue to deteriorate which will significantly damage the UK economy'.²⁹

Therefore, after taking *what is not seen* into account, the prevailing consensus could be described as follows. After taking £90 billion each year in taxes from successful companies across the UK,

27 *Corporation Tax, T11.1, Statistical Office, May 2009.*

28 *Total Tax Contribution, PricewaterhouseCoopers LLP, 2008 survey for The Hundred Group.*

29 *UK Business Tax: A Compelling Case for Change, CBI, 2008.*

the government accuses these same companies of failing to make a sufficient investment in R&D for some other completely unrelated reason.³⁰ In an attempt to solve the problem of a lack of R&D investment, which they have in all likelihood just created, the government decides to re-invest a very small percentage of the £90 billion back into research and development. However, the government isn't simply handing the money back to each business so that they can spend it on an existing R&D project, which they have previously been accused of neglecting. Instead, these funds will now be spent on some entirely different and unrelated research carried out by academic researchers based at publicly-funded universities across the UK. Finally, the government attempts to convince companies that they are doing them a great favour by making this unrelated research available from a local university free of charge.

To add insult to injury, companies are then accused of failing to make full use of the unrelated research that they have already paid for, and which has now become available. As Lord Mandelson, the business secretary, put it, one of the biggest challenges lies not with universities, but with businesses 'who simply don't realise the resources they have down the road in the local lab'.³¹ This is *what is seen*. However, *what is not seen* is that the process of R&D is difficult enough even when it is carried out internally, directly funded and controlled by the company itself. However, when a company doesn't even know that they are subsidising R&D, or indeed where this research is being carried out and for what purpose, the chance of this investment having any positive impact

30 Clearly the fact that the government has just removed £90 billion from their bank accounts is going to have at least some impact on how much they can now afford to invest in R&D.

31 Speech by Peter Mandelson, 'Higher Education and Modern Life', Birkbeck University, 27 July 2009.

on each of the companies which are funding it must be close to zero. With the benefit of hindsight, the fact that the research councils can highlight a number of isolated instances where their research grants *have* helped to develop new products and services or created new companies is a remarkable achievement in itself.

In a speech in September 2009, the Chancellor, Alistair Darling suggested that despite his government's doubling of the science budget, they still wanted to go further and he concluded that '[t]he private sector couldn't do that alone – it needs to go alongside public investment'.³² *What is not seen* here is the fact that there is really no such thing as public investment in R&D, if the £2.8 billion spent by the Research Councils in 2007 was funded out of the £90 billion of tax receipts collected from businesses during the same year. Instead, all investment is ultimately privately financed, the only difference being whether it is carried out by individual companies or by Research Councils and universities. While the Chancellor gives the impression that public investment represents a completely separate source of income from any private investment, this is simply not the case. The illusion is created by transferring some of the private funds to the government. Therefore, when the prevailing consensus states that government needs to invest to complement industry funding in order to raise research funding to the socially optimum level, *what is not seen* is that this is probably yet another call for the government to increase the burden of taxation on business, thereby restricting businesses ability to invest in R&D even further.

This illusion is also proving sufficient to convince many companies that when they accept public subsidies, this represents a cost free government handout. For example, the Economic and Social

32 Speech by Alistair Darling on Tuesday 8 September 2009.

Research Council (ESRC) claims to be the UK's largest public funder of business research and its Business Engagement Project (BEP) has recently attempted to identify the key management challenges in a number of business sectors. The purpose of the research is 'to assess the demand for academic research to address these challenges'. One sector examined was management consultancy. From research undertaken to date a number of management priorities have been identified. These include the following: the professionalization of the industry; the procurement of consultancy services; dealing with risk; the role and management of innovation in consultancy relationships; consideration of alternative business models; and human resource issues. The project reported that it had found a number of areas where academic research could make a valuable contribution, and claimed to show that 'when directly engaging with practitioners, potential users of research output can make useful and credible suggestions for topics of research'.

While the consultancy companies may have been happy to cooperate with this project in the belief that it was not costing them anything, *what is not seen* is that they are paying for this research, albeit indirectly, via taxation. Successful management consultancy companies are therefore being taxed to help fund university-based academics carry out research, the sole purpose of which is to find out if any further academic research is required to help management consultancy companies improve how they manage their own business – a subject in which management consultancies themselves are supposed to excel!

What is also not seen is that the increasing burden of business taxation is often driven by business leaders and their representatives, who continue to plead for further subsidies. For example,

according to Sir John Chisholm (Chairman of QinetiQ and the Medical Research Council), the investment case for research is seldom compelling for individual companies, since research is inherently unpredictable and the benefits are integrated across the economy. This is why 'it is a natural public good investment for government'.³³ *This is what is seen.* However, *what is not seen* is that Sir John is suggesting that the solution to QinetiQ's lack of investment in R&D can only be found by using the tax system to take money from all other businesses, in order to subsidise his. Therefore, the question that must be asked is whether Sir John would be happy approaching other businesses in his area, including competitors and small and medium sized companies, to demand that they make a financial contribution to QinetiQ's R&D budget? How would Sir John justify this demand on the doorstep? Would his assertion that research is inherently unpredictable, and that the benefits are integrated across the economy, be sufficient? And if Sir John was not successful in guaranteeing any voluntary contributions, should these companies now be forced by law to make a contribution? Like it or not, this is the reality of the current system.

Echoing similar developments across the rest of higher education, the Research Councils have also been asked to carry out economic impact studies to help justify their use of public funds. The Research Councils jointly describe 'impact' as the contribution that research makes to society and the economy. This embraces all of the different ways in which research-related knowledge and skills allegedly benefit individuals, organizations and nations – by fostering global economic performance, and specifically the economic competitiveness of the United Kingdom; by increasing the

33 Sir John Chisholm (Chairman of the Medical Research Council and QinetiQ Group plc), *Universities and Industry: A perspective on the 21st century relationship*, September 2008. p.4.

effectiveness of public services and policy; and by enhancing quality of life, health and creative output.³⁴ In short, an action or activity is said to have an economic impact 'when it affects the welfare of consumers, the profits of firms and/or the revenue of government'.³⁵

However, these definitions are clearly based entirely on *what is seen*, because they are taken from the point at which public funds are spent. Any benefits associated with public spending on R&D are identified as an economic benefit. For example, an economic impact study published by Research Councils UK in 2008 concluded that every research council 'makes a significant contribution to wealth creation and quality of life within the UK'.³⁶ However, *what is not seen* is that this fails to take into account the economic activity that has been prevented from taking place by transferring the £2.8 billion from the taxpayer to the Research Councils in the first place. It should be self evident that when the Research Councils spend £2.8 billion on research, successful businesses are forced to spend less. Again this does not represent an addition, but simply a transfer of income. As it is impossible to find out if the £2.8 billion would have more of an economic impact if it is spent on R&D than if businesses spent it themselves, there is no evidence to show that this transfer will provide any economic benefit to the nation as a whole.

In a 2008 report entitled *Leading the World: The Economic Impact of UK Arts and Humanities Research*, the Arts and Humanities

34 *Leading the World - The Economic Impact of UK Arts and Humanities Research*, 2009, p.5.

35 *Increasing the economic impact of Research Councils Advice to the Director General of Science and Innovation*, DTI from the Research Council Economic Impact Group, 14 July 2006, p.12.

36 *Excellence with Impact - Progress in implementing the recommendations of the Warry Report on the economic impact of the Research Councils*, PA Consulting Group/SQW Consulting.

Research Council (AHRC) concludes that £100 million on arts and humanities research generates an 'enormous economic impact'.³⁷ This is *what is seen*. However, *what is not seen* is that by transferring £100 million from the taxpayer to the AHRC, the taxpayer consequently has £100 million less to spend, which will have an enormous negative economic impact. Again, the important question to ask is whether the £100 million will have a greater economic impact if it is spent by the AHRC or if was left with the taxpayer to spend in their local community? To help answer this question, listed below are three case studies of research projects that received AHRC funding in 2009:

- *Mediating Post-Soviet Difference: An Analysis of Russian Television Representations of Inter-Ethnic Cohesion Issues* (£426,395);
- *Transforming Technologies and Buddhist Book Culture: The Introduction of Printing and Digital Text Reproduction in Tibetan Societies* (£711, 196);
- *Favela to the World: a Knowledge Transfer collaboration between People's Palace Projects (QMUL) & the AfroReggae UK Partnership* (£369,885).

While these projects may help to promote and encourage the arts and humanities, it is clear that the £1,507,476 spent is not going to have a greater economic impact than if it was spent by the taxpayer directly. It is therefore fair to conclude that transferring £100 million from the taxpayer to the AHRC will result in less economic growth and not more. This conclusion is hardly surprising as the original purpose of most of the research funded by AHRC is not to stimulate

³⁷ *Leading the World: The Economic Impact of UK Arts and Humanities Research*, Arts and Humanities Research Council, 2008, p.24.

economic growth at all, but to promote the arts and humanities.³⁸ While there may be reasons why the government wants to take money from the general taxpayer (including those on low incomes), to help subsidise research into the arts and humanities, it is clearly misleading for any government to try to claim that this transfer of income will help to generate any additional economic growth. Ultimately governments can only restrict and distort economic growth and development, if they attempt to tax businesses to fund either business-related or academic research.

38 The fact that an economic impact test is being carried out on AHRC's research, suggests that there is now some confusion surrounding the original purpose of the research. Just as business related research is not expected to directly promote the arts and humanities, it is unclear why research in the arts and humanities is now expected to promote economic growth.

3.2 There is no such thing as free higher education

Higher education in the UK was 'free' until the introduction of tuition fees in 2003, which required students to make a financial contribution themselves. This is *what is seen*. *What is not seen* is that there is no such thing as free higher education. Even after the introduction of tuition fees, university courses are heavily subsidised, which involves the government taking money from the general taxpayer (including those on low incomes) and giving it to students and universities. In short, to help fund higher education the government has ended up taxing the poor to help subsidise the rich getting richer.

Bastiat warned of the corrupting immorality that seeps into the political system when politicians put themselves at the service of well-organised and influential interest groups. When attending the French National Assembly while subsidies were on the agenda, Bastiat was appalled to see 'with what shameless rapacity everyone tries to make sure of his share of the plunder'. While many individuals and interest groups were more than happy to plead for government

subsidies at the National Assembly, they would blush at the thought of being forced into taking the money from the people themselves. It was clearly much easier to get the government to do their dirty work for them. A plea for public subsidies is not a plea for government money, but rather a request that the government take money from those who have earned it in order to give it to those who claim they need it. In light of this, Bastiat defined the state as ‘the great fiction through which everybody endeavours to live at the expense of everybody else’.³⁹

The story of the broken university in the UK starts in 1889, when several private colleges, acting as a well-organised and influential interest group, persuaded the government to take £15,000 from taxpayers’ wallets and transfer it to them. Within thirty years, this transfer of income had increased to £1 million. As universities soon lost sight of where the subsidies were coming from, they had no hesitation in continuously asking for more. Universities also started to fall into the trap of looking to the government to solve an increasing number of their problems, which inevitably created a culture of dependency, where the thought of surviving without government subsidies became inconceivable.

Whatever the historical reasons for the growth of public subsidies in higher education, it is impossible to escape the fact that some of the taxes being paid by the general taxpayer (including those on low incomes), are now being used to support students who would (a) be prepared to invest in their university education themselves; (b) come from families who would have been prepared to cover the full cost of their children’s university education; and (c) expect to earn much more after graduating than many of those who are now being forced to subsidise them.

39 Bastiat, *Government*, 1848.

This perhaps helps to explain why there is very little discussion within the academic community about the way in which higher education is funded, or which particular individuals and organizations academics believe should be taxed to help subsidise their salaries, research budgets and institutions. It is a subject that many would prefer to ignore. That said, the hidden cost of government intervention in higher education has been criticised by Professor Nicolas Barr (LSE), who suggested that those campaigning against tuition fees would do well to recognise the simple fact that ‘free’ means ‘someone else pays’⁴⁰ and concluded that ‘the evidence is unambiguous: ‘free’ higher education redistributes from poor to rich’.⁴¹ Professor Andrew Oswald (University of Warwick) has also described the British system as unethical, because of the barely discussed subsidy from the badly off to the rich. He concludes that ‘[e]very year, poor families contribute hundreds of pounds through their taxes to each undergraduate in Great Britain. That is immoral’.⁴²

Professor Oswald also refers to the muddled logic of many left-wing commentators, who continue to believe that taxing the poor to subsidise the rich is somehow egalitarian. This is not a phenomenon that is unique to the UK. As Milton and Rose Friedman admitted of the US, ‘those of us who are middle and

40 According to Bastiat, ‘The truth is, the word “gratuitous” as applied to public services contains the grossest, and, I may add, the most childish of fallacies. I marvel at the public’s extreme gullibility in being taken in by this word. People ask us, “Are you against *gratuitous* education? Quite the contrary! I’m for them and I would also be for gratuitous food and gratuitous housing . . . if these were possible. But the only thing that is really gratuitous is what does not cost anyone anything. Now, public services cost everybody something; the reason they cost the receiver nothing is that everybody has paid for them in advance’. Bastiat, *Economic Harmonies*, Chapter 17.

41 Speech by Nicholas Barr (Professor of Public Economics at LSE), ‘Raise the cap on top-up fees!’, The Great Debate – How should Higher Education be funded?, London First, 21 September, 2009.

42 Speech by Andrew Oswald (Professor of Economics, University of Warwick), ‘Universities, Quality and the Future’, British University Finance Directors Group Conference, 14 April 2003.

upper-income classes have conned the poor into subsidising us on a grand scale – yet we not only have no decent shame, we boast to the treetops of our selflessness and public spiritedness'.⁴³ A similar sense of selflessness and public spiritedness continues to play a role in the national debate on higher education in the UK. For example, union leaders have promised to name and shame every MP who refuses to sign a pledge to oppose a rise in university fees. This is *what is seen*. However, *what is not seen* is that if an MP signs this pledge then that implies that they not only support the current policy of taxing the poor to subsidise the rich, but that they also want this burden of taxation to be increased even further. It will also imply that the MP believes that even though many students and their families can afford to fund their own university education (often via loans), it is much better if they continue to live at the expense of others, including those on low incomes. *What is not seen* is that the real shame lies with those special interest groups who demand to live at the expense of everybody else, but who would blush at the thought of having to approach the public directly, instead preferring to shame politicians into doing their dirty work for them.

43 Milton Friedman and Rose Friedman, *Free to Choose*, 1980, p. 172.

3.3 Undermining the autonomy and independence of private institutions

In February 2009 the Secretary of State for Innovation, Universities & Skills stated that the strength of the current higher education system, and a prime reason for its world-class status, was the 'autonomy of the universities and colleges themselves'.⁴⁴ In April 2009, Tim Melville-Ross (Chair of HEFCE) stated that institutional autonomy should remain at the heart of the UK's higher education system and that preserving this autonomy would be HEFCE's most important role in the future.⁴⁵ This is *what is seen*. *What is not seen* is that as the level of public subsidy has continued to increase, so has the level and nature of government interference and control, which over time has clearly undermined the independent status of universities in the UK.

If universities in the UK were all public institutions, then this would not be a cause for concern. However, according to the Committee

⁴⁴ Higher Education Debate, 24 February 2009.

⁴⁵ HEFCE Annual Conference, 2009.

of University Chairs, despite each university being different in origin, size and organization, they all share the following characteristics: legally independent corporate structures; charitable status; and accountability through a governing body which carries ultimate responsibility for all aspects of the institution.⁴⁶ This basic legal distinction between a public and a private institution is important because it is supposed to protect the autonomy and independence of private institutions by providing legal protection against arbitrary and unwanted government interference. In higher education, however, it would appear that the distinction between the two and the rules restricting government interference have been broken.

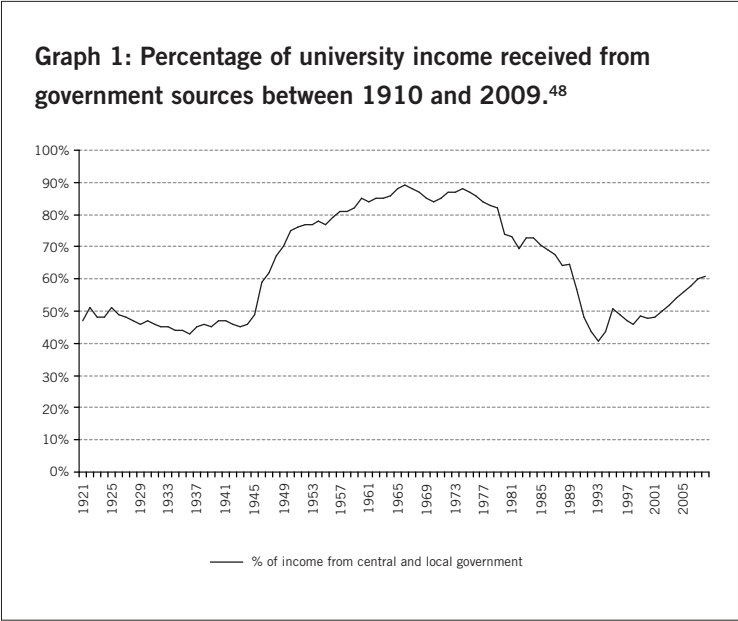
The ongoing confusion over the legal status of universities is perhaps not surprising when the current level of government interference and control is considered. While governments may not have intervened in higher education to purposefully undermine the autonomy and independence of universities, it is clear that this has been the result.

The history of government intervention in higher education shows that even by the late 1920s universities were dependent for their survival on public subsidies, making it difficult – if not impossible – for politicians to reverse these previous decisions. Therefore, although it started as the pleading of several private colleges for minimal financial assistance, it wasn't long before the government assumed responsibility for meeting all universities' future financial needs. Post-1945, government intervention also attempted to match the universities future needs with the so-called manpower needs of the nation. Centralised national planning began to dictate the future growth and development of the sector. Instead of universities having to appear cap in hand before the government they were now

⁴⁶ *Guide for Members of Higher Education Governing Bodies in the UK*, Committee of University Chairs, March 2009, p.36.

identified as an important national asset. Government intervention was therefore required, not only to increase the level of investment in higher education, but also to implement the national plan, and to address a number of fundamental educational issues. According to Simons (1989), these goals have remained the same ever since and now include ‘who should be educated, how, to what level or different levels of the service of what social or industrial needs?’⁴⁷

The following graph shows the changing percentage of university income that universities received from government sources throughout the twentieth century.



47 B. Simon, ‘The History of Education’, in P. Gordon; R. Szepter (Eds) *History of Education: the Making of a Discipline*, Economica, Paris, 1989, 55–72.

48 V. Carpentier, *Historical Statistics on the Funding and Development of the UK University System, 1920–2002* [computer file]. Colchester, Essex: UK Data Archive [distributor], July 2004, SN: 4971.

The graph shows that as early as the 1920s, some universities were already receiving more than 50% of their income from government sources. This would become a more permanent feature in the period immediately following World War II. According to the European Community Directives on public procurement, a university is identified as a 'body governed by public law' if it receives more than half of its income from public subsidies.⁴⁹ Therefore, according to this definition, those universities in the UK that continue to receive more than 50% of their income from government sources can no longer be described as being autonomous and independent. With the level of income from government sources increasing to over 85% in the 1970s, it would be naive to believe that this level of funding has not had a significant influence on how universities operate and perform. The graph also shows that since the late 1970s, the percentage of income from central and local government has declined from over 85% to just over 60% today. However, the fact that the level of government interference has moved in the opposite direction during the same period reinforces a popular criticism of government bureaucracy, which is that after a period of time it develops into a permanent feature, making it much more difficult to reverse.⁵⁰ This certainly appears to have been the case in higher education, where government regulations, quangos and committees are now viewed as permanent and essential features of the UK's higher education sector.

49 *Guide for Members of Higher Education Governing Bodies in the UK Governance Code of Practice and General Principles*, Committee of University Chairman, November 2004, p.24.

50 A December 2009 report, *University Autonomy in Europe*, published by the European University Association, suggests that even though national governments and the European Commission recognise the fundamental importance of university autonomy in the 21st century, governments are still exercising far too much control and they are still either reluctant or unwilling to withdraw.

An effective method of controlling the actions of universities has been through the use of conditions or financial penalties attached to each government grant. Admittedly, it remains unclear what financial penalties past governments would have been prepared to inflict on universities. However, the *fear* of financial penalties has been sufficient to allow the government to extend its powers into almost every area of university life. For example, price capping was sanctioned in Section 23/24 of the 2004 Higher Education Act, imposing a condition on the governing body of each institution to ensure that its tuition fees did not exceed the specified limit. Any institution failing to meet this condition is now threatened with financial penalties, including the repayment of government grants and the restriction of any future grants. *What is not seen* is that this form of direct government interference is at odds with the independent legal status of universities, as they are supposed to be accountable through a governing body that carries ultimate responsibility for *all* aspects of that institution. If a university is no longer ultimately responsible for determining the price of the services that they provide, then it can no longer be described as either independent or autonomous.

Another method of controlling the actions of universities has been through the introduction of detailed government regulations relating to almost every aspect of university management. For example, if a university wants to take on a new long-term financial commitment, then it must first seek permission from HEFCE. They will only consider such a request when the following information has been provided: a brief description of the new investment and why it is necessary; an explanation of how it broadly fits with the institution's mission and strategic priorities; confirmation that the institution has followed HEFCE guidance on appraising investment decisions; the forms of finance considered and the selection

process and criteria; the net present value for each financing option and a brief explanation of why the chosen method was selected; details of the chosen option, including the name of the lender, the sum borrowed, the loan period and the basis of repayment; terms and conditions of the financing (for example, a copy of the offer letter) and an evaluation of the risks and uncertainties; an update of the latest financial forecasts, to include the impact of the new investment and financial commitments; details of when the governing body approved the new investment and financial commitments and a minute of the decision reached; and finally a summary of the information the governing body received in reaching its decision. This one example suggests that universities in the UK are now subject to a remarkable level of interference in their day-to-day management. In no other sector of the economy are private institutions subject to such a highly regulated working environment. According to Sir David Watson (Professor of Higher Education Management, Institute of Education), '[t]he amount of political activism and organizational tinkering with higher education that has taken place in the UK is astonishing by both absolute and comparative standards'.⁵¹

Following his review of the key developments in higher education, Professor Michael Shattock (Institute of Education) concluded that the sector has moved from being 'privately to publicly governed, essentially changing from self governance to governance explicitly by the state'.⁵² However, not only are universities now deemed to be governed by the state, they are also often thought of as being state institutions themselves. The fact that the University of Buckingham is frequently referred to as the only private or independent

51 Hannah Fearn, 'Tinker, tailor, tamper, why?', *Times Higher Education*, 3 December, 2009.

52 Michael Shattock 'The Change from Private to Public Governance of British Higher Education: Its Consequences for Higher Education Policy Making 1980-2006', *Higher Education Quarterly*, Vol 62, No.3, July 2008, p.181.

university in the UK clearly implies that many people believe that every other university is neither private nor independent. The government's 2009 national plan only added further confusion to the debate by stating that '[a]longside the development of our publicly funded universities and colleges we also see an important role for *fully* private providers over the next 10–15 years' (italics added).⁵³ This implies that all publicly funded private universities are no longer *fully* private. If this is the case, then what are they?

This ongoing state of confusion surrounding the legal status of universities is reflected in the following statement made by Peter Knight back in 2006, when he was the Vice-Chancellor of UCE Birmingham:

*If the policy is that universities are to be private bodies, then stop the micromanagement and treat them as such. As the universities dangle uncomfortably in the void between the public and private sectors, they get the disadvantages of both and the advantages of neither. If only someone could make their mind up which it is to be and stick to it!*⁵⁴

Unfortunately for today's Vice Chancellors, even if the current Secretary of State does make up his mind and stick to it, his decision could still be reversed or significantly changed when a different government is elected.⁵⁵ All this suggests that there has been a break down in the rule of law in higher education, resulting in arbitrary interference by the government as and

53 *Higher Ambitions - The future of universities in a knowledge economy*, Department for Business, Innovation and Skills, 2009.

54 Peter Knight, 'So, are universities public or private?', *The Guardian*, 20 June 2006. .

55 For further discussion on the autonomous, independent and private status of UK's universities see *The English chartered university/college: how 'autonomous', how 'independent', and how 'private'?* by David Palfreyman, Director, Oxford Centre for Higher Education Policy Studies.

when it pleases. As a result the government is no longer bound by any fixed rules and it remains unclear what the extent and nature of government interference in higher education will be in the future. It is difficult to see how any world-class institution can expect to flourish within such a highly regulated, confused and unpredictable working environment.

3.4 Crowding out philanthropic donations

US universities have been much more successful at attracting large endowments than their UK counterparts because the US has always had a strong tradition of private philanthropy in higher education, which has not been the case in the UK. This is *what is seen*. However, *what is not seen* is that there also used to be a very strong tradition of philanthropy in higher education in the UK, with philanthropists playing a key role in the founding of hundreds of colleges, institutes and academies across the UK during the eighteenth, nineteenth and early twentieth centuries. This has been confirmed by Professor Eric Thomas (Vice Chancellor of Bristol University) who admits that, 'perhaps we allowed it to slow or even cease in the period after the Second World War, and are only rediscovering it now'.⁵⁶ A more accurate interpretation of events has been provided by Jon Dellandrea, a leading fundraiser in higher education, who suggests that '[e]verything screeched to a halt post-Second World War, maybe earlier, when the welfare state meant that university was free, healthcare was free,

⁵⁶ Eric Thomas, 'University fundraising: Please give generously', *The Journal*, 28 January 2009.

taxation was high, and the attitude was ‘I gave at the office, thank you very much’.⁵⁷ In a recent academic article, Eve Proper (Peabody College of Education, Vanderbilt University) stated that ‘[g]overnment funding drove out most private giving as support for higher education was transformed into a government responsibility’.⁵⁸

While no government policies have been introduced with the specific aim of reducing philanthropy in higher education, a number of developments coincided, which had the unintended consequence of restricting and discouraging philanthropic donations throughout the sector. Firstly, before World War I the government’s share of GDP was approximately 10%, which increased to 25% by 1919 and to over 45% post-World War II. Dramatic increases in taxation over such a short period of time had an impact on all philanthropic activity, especially in those sectors which the government now promised to subsidise.⁵⁹ Secondly, while the government had initially attempted to encourage philanthropic donations by offering matching grants, by the mid 1970s government subsidies were in the form of ‘deficiency grants’, so any increase in income from endowments (or tuition fees) would automatically result in a decrease in the government grant. All incentives for universities to increase the level of endowments were therefore removed and universities became increasingly reluctant to be seen as being well endowed or affluent for fear of losing government support. As subsidies were initially introduced to save universities from financial collapse, there may have been

57 ‘Cash flows when academic passion is shared, says philanthropy tsar’, *Times Higher Education*, 29 May 2008.

58 Quoted in Hannah Fearn, ‘A gift would mean so much’, *Times Higher Education*, 6 August 2009, p.30.

59 According to S.J. Curtis (History of Education in Great Britain, 1968, p.465) this rapid increase in the levels of taxation also meant that fewer parents could afford to fund their children through university, resulting in an increasing number of students becoming dependent on government handouts.

the sense that these subsidies were now contingent on universities remaining financially unsustainable. Thirdly, as universities become increasingly dependent on public subsidies (especially after 1945) their attention was increasingly diverted towards securing these funds and to satisfying the attached conditions. Universities would therefore only look to attract philanthropic donations when they failed to attract government subsidies. The more generous the government is when distributing subsidies, the less need there is for the university to seek philanthropic support. Fourthly, as universities gradually became recognised as being heavily subsidised and controlled by governments, they became less attractive to some philanthropists.

In previous years, philanthropy played an important role in helping to finance and stimulate interest in research and development in the UK, across all academic fields. For example, the Joseph Rowntree Foundation was established in 1904 to help tackle the root causes of social problems and it continues to spend over £10 million a year on related research. A more recent example can be found in the US, where Sir John Templeton set up the John Templeton Foundation in 1987 with assets of \$1.5 billion. The mission of the Foundation is to serve as a philanthropic catalyst for discovery in areas engaging life's biggest questions:

These questions range from explorations into the laws of nature and the universe to questions on the nature of love, gratitude, forgiveness, and creativity. Our vision is derived from Sir John Templeton's commitment to rigorous scientific research and related scholarship. The Foundation's motto "How little we know, how eager to learn" exemplifies our support for open-minded inquiry and our hope for advancing human progress through breakthrough discoveries.⁶⁰

60 John Templeton Foundation website (www.templeton.org).

Unfortunately, despite the vast increases in wealth in the UK since 1904, there has not been a corresponding increase in the number of private research foundations, addressing issues such as those outlined above. Instead, it is the government and its research councils that are now attempting to dominate the market for both industrial and academic research. Therefore, *what is not seen* are the numerous research foundations that would have been established, if only the government had not attempted to dominate the sector.

Finally, to suggest that government intervention has crowded out philanthropy in higher education is not to deny that some large-scale philanthropy has taken place since 1945 – it clearly has. However, these donations only represent *what is seen*. *What is not seen* are the thousands of philanthropists and alumni who may have considered, or could have been persuaded to donate money to universities if only the government had not intervened in the manner and to the extent that it has.

3.5 Combining and confusing academic, professional and vocational education

If a university is to gain world-class status then it must excel in all areas of higher education, combining academic, professional and vocational studies. This is *what is seen*. However, *what is not seen* is that today's publicly funded universities are only attempting to be all things to all people because of the way in which successive governments have funded them, and because governments have also expected them to provide access to all of the different subject areas. As a result the concept of specialization appears to have bypassed the higher education sector altogether and universities have instead moved indiscriminately into all areas of higher education and professional training. Many of these could be delivered more efficiently and effectively in the for-profit private sector. Evidence to support this claim comes from the rapid growth in non-subsidised universities in the US and around the world, which specialise in delivering a variety of professional and business-related courses. If this new generation of for-profit institutions can

provide the same or better services at no cost to the taxpayer, this further undermines the need for public subsidies.

Without government intervention, colleges and universities would have been more likely to specialise and many would have developed into very different institutions.⁶¹ Instead, an unintended consequence of government intervention has been the growth of what has previously been defined in the US as the multiversity:

*The multiversity is an inconsistent institution. It is not one community but several. A community . . . should have common interests; in the multiversity, they are quite varied, even conflicting. A community should have a soul, a single animating principle; the multiversity has several – some of them quite good although there is much debate on which souls really deserve salvation.*⁶²

An important hidden cost associated with this indiscriminate expansion involves the costs associated with having to design all professional and business related courses so that they conform to the traditional academic model. Not only have these new courses adopted the traditional academic qualification of a degree, they have also adopted the traditional academic calendar, the traditional academic method of teaching and the traditional academic pay scales. It is also likely that the organizational structure, traditions and culture of a non-profit academic university may not be the most

61 For example, most of the for-profit higher education institutions in the US focus their activities on delivering educational programmes in career-orientated fields. However, those that are quoted on Wall Street are more likely to concentrate their programmes on computer science, business and health, with over 80 percent offering at least one of these three courses. The 'Wall Street' universities are found to have an even narrower focus than the for-profits in general – offering only 26 specialities compared to 36 programmes in the for-profits in general.

62 Clark Kerr, *The Uses of a University*, Harvard University Press, 1963/94, p.14.

efficient way for an institution hoping to deliver world class business related education and research services to work.⁶³

Despite the best efforts of universities to excel in both academia and business education and training, there is still some confusion about what the primary role and purpose of each university should be. For example, Sally Hunt (General Secretary of the University and Colleges Union) suggests that universities should be first and foremost ‘a learning environment, not a training camp for business’.⁶⁴ According to the Prime Minister, the purpose of university education is the empowerment and intellectual development of the individual and ‘the course and the job a student goes on to, is secondary to that’.⁶⁵ If this is the case, then perhaps it helps to explain why so many universities are currently attempting to excel in the delivery of business related courses, but still place very little emphasis on the job a student goes on to. Finally, if universities are not training camps for the world of business, then where are the world-class institutions which market themselves as being training camps for business, where the course and the job a student goes on to are not only their primary concern but their sole concern? This is *what is not seen*.

While many people may have their own personal opinions on what they would like universities to be or to become, the opinions that should count are those of people who own, control or govern each private autonomous and independent institution. If universities are truly autonomous and independent then by law it is these people, and these people alone, who are responsible for deciding

63 There also seems to be something odd about a non-profit organization attempting to deliver courses on the art of profit making. One would assume that it must be possible to generate a profit from teaching others to how to generate a profit.

64 ‘The class of 2020?’ *Times Higher Education*, 27 November 2008.

65 Gordon Brown, quoted in ‘The class of 2020?’, *Times Higher Education*, 27 November 2008.

the nature and purpose of the institution and how they want it to develop in the future. It is also impossible to ignore the fact that at some point in the near future the current Prime Minister will be replaced by another politician who may well have very different views concerning the future of higher education.

A further hidden cost of universities expanding indiscriminately into the delivery of professional and vocational courses is that those representing the business community in the UK have also developed the habit of expecting politicians to solve an ever-increasing number of their problems. For example, on the CBI's website under the heading 'What should government do?' it recommends that the state must '[e]nsure there is public funding to support university programs geared to employer needs'.⁶⁶ While many businesses may believe that there is no cost from the CBI making such demands on their behalf, *what is not seen* is that there is a significant cost as '[b]usiness contributes a quarter of the taxation income that funds HE through direct business taxes'.⁶⁷ Therefore, by making such demands the CBI helps to legitimise the current burden of taxation on business and also encourages the government to increase this burden even further.

Unfortunately, *what is also not seen* is that as far as each university is concerned, the income that they receive each year from businesses will be recognised as being part of the much larger public subsidy. They will therefore have no idea how much they receive indirectly from businesses, with many universities unaware that they receive any contributions at all from the business community. Therefore, because the funds are directed via the government, the link between each business and each university

66 The CBI higher education website (<http://highereducation.cbi.org.uk/policy/workforce-training/what-should-government-do>).

67 *Key Facts 1*, CBI HE Task Force, September 2008.

has been broken so that the influence a customer usually has when paying for a service directly is lost. As a result even if business contributions were doubled overnight, the standard of service they receive in return would not change because it would still be identified as a general public subsidy and not a direct payment. Individual businesses would also find it difficult to double their contributions overnight, simply because they themselves also have no idea about how much they are currently contributing to higher education via taxation. Therefore, while the CBI demands that there is public funding to support university programs geared to employer needs, *what is not seen* is that universities will only design and deliver courses to meet employer needs when employers pay for them directly. *What is also not seen* is that when a business makes a contribution to higher education via taxation and receives nothing in return, this constitutes a loss.

A further unintended consequence of universities expanding indiscriminately into the delivery of professional and vocational courses is that this has encouraged successive governments to engage in the practice of manpower planning. This central planning mentality has flourished under the current government and is reflected in the following statement made by John Denham in March 2009:⁶⁸

The higher education system needs to play a fuller and more organised role in meeting the national needs for strategic skills. In developing our national competitive strengths we have to ensure that the labour market has the right people with the right skills at the right time.

68 In March 2009 John Denham was Secretary of State for Innovation, Universities and Skills.

When adopting this mindset politicians easily fall into the trap of treating students like some form of raw material which needs to be controlled and carefully managed so that they can then play their full part in meeting so-called national needs.⁶⁹ John Denham continues:

At DIUS we have seen for some time that individual learner demand or employer demand alone is not sufficient to shape the education and training system, to deliver the necessary numbers of people with the right qualifications. Their individual influence is too weak to shape the system.⁷⁰

What is meant by ‘the necessary numbers of people with the right qualifications’? What is this magical ‘necessary number’ and how is it calculated? What is meant by the ‘right qualifications’ and who decides what they should be? What if these ‘national needs’ come into conflict with the needs of students? Are the needs of students now to be dismissed? Finally, while Denham attempts to identify the lack of the right people with the right skills in the economy as an example of market failure, *what is not seen* is that manpower planning has been popular with successive governments in the UK from at least the 1960s onwards. Individual learner demand and employer demand have played only a limited role in shaping the education and training system. Therefore, if any shortages exist, then this is a direct result of government interference and a clear example of government failure. However, as Denham draws the opposite conclusion, he now believes that the solution clearly lies in continuously increasing central planning and control.

69 It is remarkable how quickly some politicians can forget their *raison d’être*, which is to serve the needs of the people and not dictate what these needs should be.

70 Speech by John Denham (Secretary of State for Innovation, Universities and Skills), One Whitehall Place, London, 24 February 2009.

The final hidden cost associated with this indiscriminate expansion of higher education and the ongoing obsession with manpower planning is that it has allowed and encouraged successive governments to develop an exaggerated sense of their own importance. As previously noted by Professor Alison Wolf (King's College, London) 'it does indeed, beggar belief that any central body can identify the needs and plan the training of a country with over 60 million people'.⁷¹ The fact that politicians and civil servants have managed to convince themselves that they are having a positive impact on the design and delivery of adult education and training services across the UK, to the extent that they believe they actually hold the key to this sector's future success, is a serious cause for concern.

71 Alison Wolf, 'Round and Round the Houses', *The Leitch Review of Skills Local Economy*, Volume 22, Issue 2, May 2007, p.112.

3.6 Suppressing, distorting and capping tuition fees

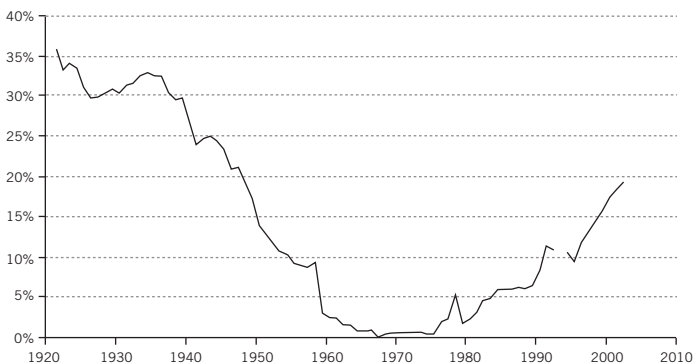
Tuition fees represent an inconvenient barrier in higher education, restricting access to students from low-income families. As a result, tuition fees should be capped and if possible abolished altogether. This is *what is seen*. However, *what is not seen* is that tuition fees should be playing the same role in higher education that prices play in the rest of the economy. Government attempts to distort or control them will have a number of perverse and unintended consequences.⁷² Furthermore, in a free and open society, if any kind of private institution wants to sell a particular service at a particular price, then they should be free to do so. Simply because some people cannot afford to purchase this service is not a sufficient reason for the government to force that institution to cap all prices, for rich and poor alike.

The impact of government interference on tuition fees is reflected in the following graph which tracks the changing percentage share

72 As noted by Sir John Chisholm in his December 2008 report *Universities and Industry*: '[i]n most markets price capping has perverse consequences' (p.8).

of university income that has been generated by tuition fees from 1920 onwards.

Graph 2: Tuition fees effectively paid by student as a share of Universities' income (%)



Source: *Higher Education and the UK Socio-Economic System*, Dr Vincent Carpentier, Institute of Education, University of London, Figure 9, p.9.

As the graph shows, the share of university income from tuition fees declined rapidly from the 1920s onwards, and between 1955 and 1990 tuition fees accounted for less than 10% of university income. Also, the fact that as early as 1920 tuition fees only accounted for just over 35% of university income, shows how public subsidies were used from the very beginning to suppress tuition fees.⁷³ The hidden costs and unintended consequences

73 In fact this was one of the key arguments used by the private colleges to justify the introduction of government grants, as noted by the following resolution passed at a meeting in Birmingham in 1880: 'That this meeting of the inhabitants of Birmingham is convinced of the national importance of maintaining in great centres of population colleges for advanced education, with such a scale of fees as will place that education within the reach of abler students of all classes.' (Birmingham Daily Post, Friday, May 27, 1887; Issue 9021).

of subsidising higher education in this way have been widespread and substantial:

Firstly, direct government grants and the offer of free or below cost higher education has increased the demand for higher education.⁷⁴ Unfortunately, because each new student now costs the government thousands of pounds each year, and because the government itself has limited access to funds, it has become unable to expand the supply of university places in order to meet the increase in demand, which it has itself created.⁷⁵ As a result, two unintended consequences are inevitable – overcrowding and rationing. Overcrowding is perhaps the most obvious and it has been well documented that the average student-staff ratio has increased over recent decades, together with the total number of students attending each individual institution. However, successive governments have also been forced into the widespread rationing of higher education.⁷⁶

In 2009 the government announced that English universities would be restricted to admitting only an additional 10,000 students – a figure which had already been reduced from 15,000 due to the onset of financial difficulties. In a letter to the Chairman of the HEFCE in January 2009, the Secretary of State reinforced the need to ‘minimise and preferably eliminate over-recruitment’, and warned

74 It is important to note that this demand is best described as artificial. As previously noted by Professor Norman Barry, it is meaningless to talk about the increasing demand for particular university courses when they are being supplied free of charge or below cost price because this tells us very little about their real value.

75 This problem is not unique to the UK. As noted by Mark Blaug, ‘[t]he world provides few examples of countries in which the demand for post compulsory schooling is not constrained by the supply of places that governments decide to make available’. *The Methodology of Economics*, 1992.

76 As noted by Samuel Brittan, ‘[w]ith zero prices there can be no limit to what is demanded. So some rationing and selection are inevitable’. *Financial Times*, 7 April 2006.

that institutions that over-recruited would face serious financial penalties. As a result it is now estimated that more than 150,000 students will be denied access to university in 2009, representing almost one quarter of those who applied.⁷⁷ This represents an extraordinary and an unprecedented level of rationing. Therefore, while the present government may have a goal of sending 50% of all school-leavers to university, it is now the government that is the key obstacle to university expansion. Also, if price capping was originally introduced to help improve access to higher education, then this provides a good example of how a well-intentioned government policy can have the opposite effect of its original intention.⁷⁸

Secondly, while using public subsidies to maintain zero or low tuition fees may have helped to increase enrolments in the short run, it has resulted in less total investment (public and private) in higher education in the long run. For example, it is widely recognised that universities in the US spend up to three times more per student than UK universities, with much of the additional two thirds of investment coming from private sources. This suggests that while the vast majority of students in the UK are forced to accept a fairly homogenous quantity (£10,000) of higher education from government funded institutions, a percentage of students would be willing to invest more than £10,000 if they had the opportunity to do so. Universities are therefore in a situation in which the government can no longer afford to increase public subsidies, while at the same time they continue to restrict

77 John O'Leary, 'Record enrolments still see 150,000 miss out on a university place', *The Times*, 22 October 2009.

78 It is also worth noting that in the UK, students can only apply through UCAS to five different institutions. This system was introduced in the 1960s as the number of students began to increase, to try to bring some order to the application process. However, as noted by Professor Kedourie it was not obvious that such serious restrictions of choice were necessary and he cites the example of the US where 'students seem to manage without the benefit of such rationing, with neither chaos nor anarchy ensuring' Professor Kedourie, *Diamonds into Glass*, 1988, p.12.

universities from raising extra income through higher fees. This is despite the fact that both the government and the universities agree that extra investment in higher education is required, and the fact that many students (and their families) would be prepared to pay higher tuition fees if the government allowed universities to increase them. Therefore, as previously noted by Seldon, '[i]f a sizeable part of higher education were financed by students paying fees and by industry placing research contracts and investing in faculties . . . more money would now be going into the universities'.⁷⁹

Thirdly, as the share of university income from tuition fees declined from 1889 until the mid-1970s, universities have become less responsive to the changing needs of both students and the businesses. This problem was highlighted by Adam Smith, who complained that at the University of Oxford in the late 18th century, many professors had given up even the pretence of teaching. According to Smith, this was because Oxford was already heavily endowed, so the professor's salary was derived from a fund altogether independent of their success and reputation. As the professors no longer depended on the tuition fees paid by each student, there was little incentive to satisfy their changing needs and demands.

Therefore while students may enjoy having other people subsidise their university education, the price they have had to pay is a loss of control over the nature and content of this education and how it is delivered. Based upon Adam Smith's observations, E.G. West concluded that beyond some point, the higher the level of endowment or government subsidy a university receives, the lower its efficiency. To put it another way, the greater the share of the student tuition fees in the total revenues of a university, the greater its efficiency. E.G. West therefore introduced the 'Adam Smith

79 Arthur Seldon, 'Move universities to the market', *Economic Affairs*, 1980, p.228.

Test', where the threshold of tolerable efficiency is reached when 'the share of student fees in the total operating costs of universities rises to at least 50%'.⁸⁰ This test helps to shed light on an important contradiction which lies at the heart of the prevailing consensus, as it suggests that the more public subsidies an institution receives, or the more 'public' an institution becomes, the less responsive it actually becomes to the requirements of the public.

Fourthly, the percentage of income a university receives from student fees will not only affect how efficient the institution is or how responsive it will be to changing student demands, but will also have an influence on the ability of other private institutions to compete on a fair and level playing field. When a university is made less dependent for its funds on tuition fees, the result is less competition between providers. This point has been highlighted by Sir John Daniel (President, Commonwealth of Learning):

*Changing fees policy is important, because what the public sector does in relation to fees clearly constrains the private sector. Having a free public sector alongside an expensive private sector does not create an effective higher education system. As countries gradually introduce fees in the public sector, either because of a conviction that it is more socially equitable or because there is no financial alternative, the private sector finds itself on a more level playing field.*⁸¹

Fifthly, while attention has focused on how students benefit from not having to pay the full cost of their higher education, much less

80 E.G. West, *Reforming the Universities: The Coming Upheaval in Higher Education*, Atlantic Institute for Market Studies, 1999, p.7.

81 Speech by Sir John Daniel, 'Does American Higher Education have a Global Future?', American Association of State Colleges and Universities Summer Conference, Vancouver, 26–28 July 2007.

attention has been directed towards how this influences student behaviour. For example, while subsidised tuition may increase enrolments in the short run, students may then respond to lower tuition fees by decreasing their effort levels. If higher education is free or heavily subsidised then less interested students may also be tempted to enrol. They may pay less attention to their choice of university course and be more likely to drop out. The recent reintroduction of tuition fees in the UK and the resulting change in student behaviour confirms that the amount students have to pay for their own higher education will at least have some influence on their behaviour.

Finally, it was suggested above that tuition fees should be playing the same role in higher education as prices play in the rest of the economy. In *Common Sense Economics*, this fundamental function is described as follows: '[m]arket prices register the choices of millions of consumers, producers and resource suppliers. They reflect information about consumer preferences, costs, and matters relating to timing, location and circumstances that are well beyond the comprehension of any individual or central planning authority.'⁸² As noted by F.A Hayek, in a system where the knowledge of the relevant facts is dispersed among many different people, a price system helps to coordinate their separate actions:

*We must look at the price system as such a mechanism for communicating information if we want to understand its real function . . . The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action.*⁸³

82 *Common Sense Economics*, 2005, p.24.

83 F.A Hayek, 'The Use of Knowledge in Society', *American Economic Review*, XXXV, No.4, September 1945.

By transmitting and coordinating this information, the price system helps to overcome the widespread ignorance that often prevents the effective utilization of scarce resources. In short, freely determined prices allow for the greater utilization of knowledge.⁸⁴ According to Hayek, this insight will have important consequences once its truth has been accepted because '[e]ither you must confine yourself to creating an institutional framework within which the price system will operate as efficiently as possible, or you are driven to upsetting its function'.⁸⁵

To understand the real function of tuition fees in higher education, it is important to recognise that they should act as a mechanism for communicating important information that helps universities and students coordinate and direct their resources to where they have the greatest value. Tuition fees should provide universities with information about student needs and demands, and how much they are willing to pay to satisfy them. They should also enable students to compare the value of different courses, and judge whether they are willing to pay the price asked, or whether their money would be better spent or invested elsewhere. Therefore, *what is not seen* is that tuition fees do not act as a barrier to higher education, but rather provide a critical link between students, universities, and the business community.

It is clear that public subsidies have been used by universities to suppress tuition fees in order to maintain and increase demand for their services. This suggests that throughout the twentieth century, successive governments have failed to recognise the

84 For a more recent discussion on the role of prices in the economy see Russell Roberts, *The Price of Everything: A Parable of Possibility and Prosperity*, Princeton University Press, 2008.

85 F.A Hayek, 'The Moral Imperative of the Market', chapter in *The Unfinished Agenda – Essays on the political economy of government policy in honour of Arthur Seldon*, Institute of Economic Affairs, p.145.

important role prices play in higher education. In short, they have excelled in upsetting their function. By abolishing and capping tuition fees, the government has completely disrupted the self organising mechanism in higher education, which helps to solve the complex problem of coordinating which university courses should be provided to help meet the demands of both students and employers. By capping tuition fees the government has also distorted the value of university courses. With many university courses now priced at £3,125, how are students expected to compare and contrast different courses? Denying students this key source of information can only lead to confusion, distortion and the waste of their scarce resources. Imagine if this kind of intervention had occurred in the market for physical capital: abolishing all prices or capping prices across a whole sector of the economy would create chaos and restrict the market's natural growth and development. And if prices play such an important role in collecting and communicating information in the market for physical capital, it would be naive to believe that tuition fees do not play a similar role in the market for human capital.

While there is much talk about the importance of the new knowledge economy, and the important role which universities will be expected to play in collecting and communicating knowledge in the future, there has been much less enthusiasm about recognising the important role which tuition fees should be playing in allowing the greater utilization of knowledge within the higher education sector itself.

It is difficult to describe any sector of the economy as being world class when it doesn't have a fully functioning price system, and when politicians are free to dictate the prices for all services across the sector. The fact that it will take approximately five years,

an independent commission, a change in legislation and a large parliamentary majority, before universities can even think about increasing tuition fees, shows how ridiculous and unworkable the current system has become.

3.7 Crowding out for-profit institutions and entrepreneurial talent

In September 2007, BPP College made history by becoming the first for-profit company in the UK to be awarded degree-granting powers by the Privy Council. In July 2009, BPP Holdings Plc was acquired by the US company Apollo Global, Inc. This is *what is seen*. However, *what is not seen* is that while this was a significant and welcome development, it also suggests that for-profit institutions have been prevented from competing in the UK's higher education sector throughout much of the twentieth century, resulting in one of the UK's most important service sectors now being dominated by a select number of heavily subsidised, non-profit charities.

In mid-nineteenth century France, Bastiat found that public services will often eliminate private services of the same nature and referred to the example of the shoe industry, which he suggested would fail very quickly if the government decided to give everyone

free shoes. For Bastiat it was important to note that the new public service was simply replacing the previously existing private service, and therefore tended to add nothing to the nation's wealth. If the public service was then found to be less effective or less efficient than the previous private service, then this transfer would represent a waste of resources, restricting economic growth and leaving the community as a whole worse off. As noted by The Economist's A-Z website, '[w]hen the state does something it may discourage, or *crowd out*, private sector attempts to do the same thing . . . Crowding out may also come from state spending on things that might be provided more efficiently by the private sector.'⁸⁶

Only two decades ago non-subsidised private and for-profit universities were either marginal or absent from the majority of countries, but today these new institutions are capturing a major portion of new enrolments across Eastern and Central Europe, the Middle East, Northern and Sub-Sahara Africa, East and South Asia, and Latin America. According to a 2008 Universities UK report by Professor Roger King, more than one in three students around the world are now studying in the private sector. At a UNESCO World Conference on Higher Education in July 2009, the explosive growth of private higher education was identified as 'one of the most remarkable developments of the past several decades'. According to Philip Altbach (Director of the Centre for International Higher Education, Boston College), 'private higher education institutions, many of them for-profit . . . represent the fastest-growing sector worldwide'.⁸⁷ In some countries private spending on higher education is also now greater than public spending. In Chile, for example, private spending amounts to 1.4% of GDP, with government spending only 0.3%. And in

⁸⁶ See Economics A-Z at www.economist.com.

⁸⁷ Phil Baty, 'Remarkable' rise of the for-profit university', *Times Higher Education*, 16 July 2009.

South Korea, private spending is 1.4% of GDP, with government spending only 0.6%.⁸⁸

However, these developments lie in stark contrast to those in the UK, where the government has allowed just four new private institutions to enter the UK market since the rules were relaxed in 2004.⁸⁹ All of the other major developments have been planned and controlled by central government in accordance with their latest national plan. Critically, as government funded institutions have continued to expand into each new area of higher education and training, this has crowded out or prevented the development of private, for-profit institutions attempting to provide similar services. For example, in the government's *Higher Ambitions* paper, rather than encouraging a variety of world class institutions to invest in the UK higher education sector, the government states that they are committed to improving access to higher education, and that this 'will be achieved, as resources allow, through innovative partnerships between universities and further education colleges, and by support for new local higher education centres under the New University Challenge initiative.'⁹⁰ The unplanned and spontaneous growth of a for-profit higher education sector does not appear to be taking place in the UK.

The hidden costs and unintended consequences associated with this ongoing obsession with central planning in higher education include the following:

88 Phil Baty, 'Market grows in strength as states run out of cash', *Times Higher Education*, 26 November 2009.

89 These include the ifs School of Finance, the College of Law, BPP and Ashbridge Business School. See 'Fourth private body wins right to award degrees', *Times Higher Education*, 28 November 2009.

90 *Higher Ambitions*, November 2009.

Firstly, without for-profit institutions to invest in, private investment in the UK higher education sector has been severely restricted.⁹¹ The recent growth of for-profit universities in the US and around the world suggests that a large number of professional and vocational programmes do not need to be delivered by publicly funded institutions.

Secondly, the crowding out of for-profit institutions and private investment in higher education has resulted in the sector remaining largely a national concern. This lies in stark contrast to other world-class sectors of the economy, where a continuous flow of international investment, ideas and innovations, has helped to maintain their enviable reputation. While it may be possible for UK institutions to become world class in the design and delivery of every conceivable higher educational course and programme, it is much more likely that a future world class higher education sector in the UK will include a variety of different institutions, from both home and abroad, which excel in a variety of different, specialist areas.

Thirdly, as noted above, because the profit motive is crowded out of higher education in the UK, the sector is now dominated by heavily subsidised, non-profit institutions which are often assumed to be less likely to take advantage of consumers, especially when they are incapable of evaluating the quality of services provided. *This is what is seen*. However, *what is not seen* is that the operations of non-profit institutions are restricted in numerous ways when compared with their for-profit counterparts.⁹² For example, while a

91 According to the CBI, the UK invests 1.3% of GDP in HE, compared to 2.9% in the US. The difference between the two is largely accounted for by funding from private sources, which accounts for 62% of HE funding in the US, twice as much as in the UK – 31%.

92 For a useful insight into this issue see Regina E. Herzlinger and William S. Krasker, 'Who Profits from nonprofits?', *Harvard Business Review*, January–February 1987.

for-profit company has an inbuilt incentive to continuously reduce costs and improve efficiency (greater profits will go to universities with the lowest costs of production), a heavily subsidised non-profit institution has less of an incentive because any cost savings may translate into a reduction in the government grant. The fact that those working for non-profit institutions may not benefit financially from any cost savings may also blunt the incentive to reduce costs. Publicly funded non-profit institutions may also have less access to private finance to help fund future growth and development. Even when the finance is available, there may be less of an incentive for them to expand and multiply. Non-profit institutions are also unable to make use of important financial incentives that could be used to attract entrepreneurs and motivate their staff, such as profit sharing among top management and employee share ownership schemes. Finally, while for-profit companies are subject to a certain amount of external control from shareholders, there appear to be fewer safeguards against mismanagement and inefficiency in non-profit institutions and little effective external control on the boards and committees that run them.

Fourthly, if the higher education sector is expected to become a world-class service sector, then universities will need to attract some of the UK's best entrepreneurial talent. However, following the crowding out of the profit motive and for-profit institutions, higher education remains one of the least attractive sectors of the UK economy for entrepreneurial talent. For example, many of the incentives used to attract entrepreneurs to work at for-profit companies, such as high salaries, bonuses and share ownership, are simply not available to non-profit universities. While it is still possible to identify isolated examples of entrepreneurial activity, this only represents *what is seen*. *What is not seen* are the thousands of entrepreneurs who would have blazed new trails in higher

education if only the government had not intervened and crowded them out. They are not seen because they have decided to invest their talent and resources elsewhere.

3.8 Restricting and preventing competition and innovation

The current demands on higher education are often expressed in terms of the need for individuals and organizations to remain competitive in the new knowledge economy. This is *what is seen*. However, *what is not seen* is that this desire to remain competitive also calls for a highly competitive higher education sector, especially with reference to the design and delivery of all non-academic and business related courses. While some may claim that with 169 publicly funded higher education institutions and over 400 private institutions in the UK, sufficient competition already exists, this fails to take into account the fact that for any sector of the economy to be described as competitive, freedom of entry must be guaranteed and a level playing field established. When these factors are taken into account it soon becomes clear that higher education is one of the least competitive service sectors in the UK economy.

For example, the most important condition of any competitive market is freedom of entry. As noted by Israel M. Kirzner, this is 'the legal and institutional prerequisite for the discovery procedure

of the market'.⁹³ However, if an organization wants to establish a new university in the UK, they must first gain permission from Her Majesty's Most Honourable Privy Council, a body of senior politicians that gives advice to the Queen.⁹⁴ Until this permission has been granted it is illegal for any institution to even use the word 'university'. Furthermore, before an organization can apply to use the word university, it must first have been granted powers by the Privy Council to award taught degrees, which requires an institution to have had no fewer than four years' experience of delivering higher education programmes. It must also conform to an endless number of other regulations to ensure that the new university conforms to the existing model.⁹⁵

Moreover, by directing public funds to a select number of government approved institutions, instead of to individual students, the government has created an unfair playing field, as those institutions which receive public funds are now free to offer their services at a much lower price, thereby undercutting the market and crowding out any private non-subsidised competitors. No doubt this method of funding higher education has forced governments to restrict the number of new universities depending on its financial circumstances at any given point in time.

93 Israel M. Kirzner, *Competition, Regulation, and the Market Process: An "Austrian" Perspective*, September 1982 (www.cato.org/pubs/pas/pa018.html).

94 The Quality Assurance Agency (QAA) offers confidential advice to the Privy Council and it is the QAA's Advisory Committee on Degree Awarding Powers (ACDAP) which is responsible for considering new applications. Membership of this committee must include three members of the QAA Board, three Vice-Chancellors, one head of a non-university higher education institution, three senior members of higher education institutions, and two other persons with experience of sectors of employment that are significant recruiters of graduates. Therefore, representatives of the existing providers, who clearly have a vested interest in restricting competition, dominate the committee deciding who is to gain access to the UK's higher education market.

95 For a full list of regulations see *Applications for the grant of taught degree-awarding powers, research degree-awarding powers and university title. Guidance for applicant organizations in England and Wales*, Department for Education and Skills, DfES, August 2004.

The hidden costs and unintended consequences of restricting competition in higher education should be self-evident.⁹⁶ For example, according to HM Treasury, vigorous competition is an important driver of productivity because it ‘strengthens incentives to innovate and ensures that resources are allocated to the most efficient firms’. As competition encourages firms to reduce prices and improve the quality and choice of goods and services, ‘it is also the most effective way of ensuring that consumers receive a fair deal’.⁹⁷ The OFT’s 2009 report *Government in Markets* also states that competition drives firms to improve their internal efficiency, reduce costs, adopt new technology, invest in innovation and reduce managerial inefficiency.⁹⁸ Critically, the report also refers to the significant benefits that come from the entry or threat of entry of new firms bringing with them new ideas and different ways of operating. They will ‘create incentives for existing firms to improve their performance and develop their products, in order to avoid losing market share and being forced to exit the market’.⁹⁹ Finally, in *Common Sense Economics*, competition is identified as one of the seven major sources of economic progress because it places pressure on producers to operate efficiently and cater to the preferences of consumers. It gives firms a strong incentive to develop better products and discover lower cost methods of production.¹⁰⁰

96 According to Bastiat, ‘[i]n proportion, then, as private services enter the category of public services, they lose momentum, at least to some degree, and become sterile, not to the detriment of those rendering the services (their pay does not change), but to the detriment of the whole community’. *Economic Harmonies*, Chapter 17.

97 http://www.hm-treasury.gov.uk/ent_comp_index.htm.

98 *Government in Markets: Why Competition Matters – A Guide for Policy Makers*, OFT, 2009, p.6.

99 *Ibid.*, p.107.

100 Gwartney, Stroup & Lee, ‘What Everyone Should Know About Wealth and Prosperity’, *Common Sense Economics*, p.44-48.

The 2008 White Paper *Innovation Nation* states that, '[t]he challenge for policy-makers is to create a framework, at a national and sub-national level, where activities to support innovation are focused on co-operation between the different actors involved'.¹⁰¹ *What is not seen* here is that the lack of innovation in higher education has not been caused by a lack of cooperation between the existing universities, but rather a lack competition and the absence of a continuous flow of new providers entering the higher education market. By restricting competition in higher education, the government has not only restricted the supply of university places, but it has also removed many of the incentives which usually drive improvements in efficiency, a focus on the customer and the process of innovation, leaving all current and future students worse off.

As noted in *Governments in Markets*, government policies sometimes stand in the way of competition and 'prevent innovation from spreading'.¹⁰² A clear example of the lack of innovation spreading across the higher education sector concerns the continuing use of the academic calendar, especially in the delivery of non-academic subjects. As the University of Buckingham and BPP Business College have already shown, it is now possible to deliver an existing three-year course in two years simply by redesigning the calendar. This innovation has been discussed for some time, as the following statement in an old edition of *The Economist* suggests:

It might be possible to lengthen the academic year which lasts 24 weeks out of the 52. Oxford works only half time and the result is that four years almost are spent in giving the

101 *Innovation Nation White Paper*, DIUS, March 2008, p.77.

102 *Government in Markets: Why Competition Matters – A Guide for Policy Makers*, OFT, 2009, p.107.

*education of two years. We cannot expect that parents who are not wealthy, and who want a practical education for their sons, will send them to a university from which they are to be absent more than half the year.*¹⁰³

The fact that this statement appeared on September 28th 1867 shows how slow universities have been to respond. While the government has recently recommended that universities introduce two-year degrees, one wonders how long it will be before universities begin to take some positive action. The fact that Buckingham and BPP College have already taken the lead raises the question: why are the other universities not also trying to adopt this important innovation, which will increase the efficient use of their resources and provide significant cost savings for students? Furthermore, why have Buckingham and BPP College adopted these innovations voluntarily, while all other publicly funded universities need to be forced by the government to adopt them?

Unfortunately, *what is not seen* is that as government intervention protects universities from an endless stream of new competitors, many of the incentives to innovate or improve no longer exist. With the supply of university places continuously restricted, and with universities already at full capacity, universities don't need to innovate in order to attract more students. Instead, the government is forced to introduce its own incentives to encourage universities to improve the services they offer. What occurs spontaneously in an open market turns into a continuous struggle in a closed public sector. As a result UK higher education displays all of the typical characteristics of a sector that lacks competition and is producer-led, with universities offering students any colour as long as it is black. Students are left worse off as a result.

103 *The Economist*, 28 September 1867.

Governments in Markets concludes that '[f]or the most part, open competitive markets are the best way of maximising consumer welfare and raising economic growth'.¹⁰⁴ Compare this with the following statement made by Richard Brown, a former Chief Executive of The Council for Industry and Higher Education (CIHE), who suggests that 'higher education can never be an open market and the CIHE, Government and other informed commentators have always recognised that it is a public as well as a private good serving wider societal and personal development needs'.¹⁰⁵ This comment helps to shed light on another hidden cost associated with government intervention, which is that it has resulted in the development of a powerful interest group of 'informed' parties. These are the existing providers who are convinced that publicly funded universities are the engines of the knowledge economy. Yet it is pointless to talk about non-profit and academically inclined universities being the engine of a highly competitive, wealth creating, profit driven, free market economy, when these institutions remain protected from global markets, depend on a £14.3 billion annual subsidy for their survival, and have to put up with an unprecedented level of rules, regulations and political interference.

104 *Government in Markets: Why Competition Matters – A Guide for Policy Makers*, OFT, 2009, p.6.

105 Richard Brown, *Invest for Greatness in Higher Education – Some Funding Ideas*, October 2009.

3.9 Qualification inflation

The traditional academic qualification – a degree – is widely recognised as being the gold standard in higher education. Over the previous century it has successfully been adapted for use in all academic, professional and business-related subject areas. This is *what is seen*. However, *what is not seen* is that the academic degree only dominates all academic, professional and business related subject areas because this is the only qualification which successive governments have been prepared to fund, providing institutions with an incentive to continuously expand its use into a variety of different non-academic subject areas. This has crowded out and prevented a variety of different private qualifications from developing.

Just like monetary inflation, qualification inflation is a good example of the hidden costs or unintended consequences of government interventions. Instead of printing money in the hope of creating wealth and prosperity for all, successive governments have been busy printing (or subsidising) qualifications with the same end in mind. *What is not seen* is that this has resulted in the value of a traditional academic degree being distorted and gradually declining over time.

According to Bastiat, higher education in mid-nineteenth century France had remained uniform and stationary because it had been

'monopolised and enclosed in an enchanted circle by university degrees' which had the threefold inconvenience of 'making education *uniform* (uniformity is not unity), of imposing upon it *the most disastrous administration*, and then of making it *inflexible*'.¹⁰⁶ His concern was not only with the lack of competing institutions in higher education, but also with the lack of competition between different qualifications. Over a century and a half later the higher education sector in the UK continues to be monopolised by the medieval qualification of an academic degree, which has gradually developed into a government funded and controlled qualification that is highly regulated, bureaucratic and inflexible.

Here is how it happened. To help manage and restrict the distribution of government subsidies, both local and central government initially tended to direct their subsidies at those institutions already granted the power to award a traditional academic degree, or to those students who had enrolled on courses at these institutions. As a result, all institutions attempting to secure public funding sought degree-granting status, or looked to become part of another more established institution already granted these powers.¹⁰⁷ As there was not an agreed definition of what a degree was or what subjects these qualifications should apply to, institutions were free to apply it indiscriminately to almost every new academic and non-academic subject area. The offer of so called 'free' or heavily subsidised university education was also sufficient to attract an ever-increasing number of school leavers into higher education, thereby continuously

106 See Bastiat, 'Academic Degrees and Socialism', *Selected Essays on Political Economy*, Ch. 9, 1848.

107 This is a generalization that doesn't take into account the fact that there will have been other reasons why institutions wanted to apply for degree granting status. However, it is fair to suggest that if the government had decided only to subsidise those institutions that awarded diplomas instead of degrees, then the degree would no longer dominate the sector.

increasing student intakes and the level of government funding. This expansion was also positively supported by successive governments, who could claim that it was their enlightened leadership that was helping to continuously increase the number of school leavers entering higher education.

As the number of degrees in a variety of different subject areas continued to rise, confusion as to the value of different degrees from different universities increased, and companies soon found it difficult to distinguish between them. As a result, companies began to use the degree as a crude screening device and would eliminate all candidates applying for a job without a degree in order narrow the field and save on recruitment costs. As the number of graduates grew, companies began to advertise an increasing number of jobs as 'graduate only', including jobs previously open to non-graduates. Again, this provided a further incentive to school leavers to take advantage of the free or highly subsidised university education, as a degree was now promoted as a passport to future employment.

As the nature of the degree became less important in the world of work, those students who were less academically inclined responded by looking to enrol on the less difficult degree courses. Universities began to expand and increase access to these courses, which would increasingly come to dominate their annual student intake. Finally, as the number of students graduating each year with exactly the same type of qualification continued to increase, some students have looked to gain an additional qualification (e.g. a Masters) to provide them with another advantage in the job market. As companies are initially more interested in qualifications than practical skills, students have an incentive to gain another qualification even if this doesn't mean developing any new skills.

According to James Tooley, the end result is that young people now seem to be in universities 'simply to keep pace with government-induced qualification inflation, and because they wish to prolong the joys of youthful irresponsibility and decadence, at someone else's expense'.¹⁰⁸ Of course, if students were prolonging the joys of youthful irresponsibility at their own expense, then this would remain an entirely private matter. However, as soon as students and universities start to receive public subsidies important questions need to be asked, especially if it has been the introduction of these subsidies which is distorting both student behaviour and the nature of the qualifications provided.

It is clear that government subsidies are having some unintended and perverse consequences, with students enrolling on courses that they may have little interest in and which have little relevance to the world of work. Not only that, but after enrolling on such courses, students also appear to be content to apply the minimum amount of effort which will allow them to gain the qualification.¹⁰⁹ Furthermore, universities have responded by continuously decreasing the level, amount and standard of work required to gain a pass. If the aim is simply to get a qualification then a university with a higher pass rate may now appear more attractive to students, even if this means lowering the quality of its product. This inflationary process and spiral of decline has been described by Ronald Dore as the 'diploma disease' and has resulted in many courses becoming 'ritualistic, tedious, suffused with anxiety and boredom, destructive of curiosity and imagination, in short, anti-educational'.¹¹⁰

108 James Tooley, 'Qualification inflation', *ama-gi*, Volume 4, Issue 1, 2002.

109 As noted by Bastiat, '[a]s everyone knows, young people *have calculated the exact amount strictly necessary to earn the degree*, and they rest content with that'.

110 R. Dore, *The Diploma Disease*, p. ix, 1976.

Employers also appear to be responding in a perverse manner by recruiting graduates who have just spent three years studying a subject that has little or no relevance to their specific working environment. While gaining a degree may signal to employers that a graduate should at least have the ability to learn at a particular level, there is no reason to believe that employers would not like graduates to have learnt specific work-related skills that can be directly applied and used in the workplace. There is also no reason to believe that students wouldn't prefer to graduate with a set of specific skills that employers would find valuable, as this would clearly help to improve their employment prospects. It is also worth noting that while employers are currently forced to help fund higher education indirectly through taxation, it is doubtful that they would be interested in the majority of courses being delivered at universities if they had to pay for them directly. This is despite the fact that the government believes that it is taxing companies to help fund these qualifications, which the government still believes are providing the skills that companies desperately need but are incapable of providing for themselves.

The current state of higher education in the UK thus raises some interesting questions. For example, why are so many students who attend university in order to help enhance their career currently enrolled on a degree course that has little or no relevance to the world of work? Furthermore, why do universities continue to offer such courses, when they have the potential to offer so much more? With reference to those degree courses which appear to have little or no relevance to the world of work, Bastiat suggests that '[t]o learn an instrument which, as soon as one knows how to play it, gives out no further sound, is hardly rational' and he concludes that '[t]he explanation is to be found in a single word, *monopoly*. Monopoly

is so constituted that it paralyzes all that it touches'.¹¹¹ The same explanation applies to use of the academic degree in higher education in the UK, where universities continue to offer such courses simply because they can. Just as Henry Ford declared that his customers could have any colour of car as long as it was black, students are now free to take any kind of qualification, as long as it is a traditional three (or four) year academic degree. With a limited supply of qualifications now available and without a continuous flow of new competitors, most of the incentives to offer students anything different have gone. Students are left with no choice but to enrol on whatever degree courses are available, even though the student's preferred choice might have been completely different.

What is not seen is that because degree courses remain either free or heavily subsidised, and because the pricing system has been distorted across the entire sector, the fact that tens of thousands more students are now enrolling on such courses tells us nothing about the real demand for different courses and qualifications, or which skills are more highly valued in the marketplace.¹¹² Without the information that prices provide, both universities and students are now forced to operate in the dark.

What is also not seen is that if there was excess supply in the market and a continuous flow of new competitors, universities

111 Bastiat, 'Academic Degrees and Socialism', *Selected Essays on Political Economy*, 1848.

112 For example if the government was to offer free cars to all drivers from low-income families and placed a price cap on all other cars at £3,125 then there would be a significant increase in the demand for cars. However, this would not necessarily mean that those accepting the free or heavily subsidised cars actually needed them as many will accept the car simply because it is free or heavily subsidised. Further hidden costs would include the increase in taxation and the associated decrease in spending in the rest of the economy, an increase in traffic congestion resulting in increasing travel times, a shortage of car parking spaces, an increase in the price of petrol, an increase in road accidents, and also a decrease in demand for public transport.

would be forced to seek new students each year, as survival would no longer be guaranteed. To attract students who want to enhance their career prospects, universities would have to enter into a continuous dialogue with the business community to find out what kind of skills are highly valued and currently in demand, or will be in demand in the near future. Those universities that delivered the most highly valued skills in the most effective manner would be the ones that attracted the most students and therefore generated the most profits.

Together with the introduction of free or heavily subsidised higher education, the lack of the profit motive in higher education has also had an influence on the nature, form and quality of the qualifications that universities provide. For example, in the US, Microsoft Learning launched a series of branded qualifications in 1992 and recently introduced a new generation of qualifications in response to changing workplace demands and student needs. After IT managers had complained that the proliferation of qualifications was making it difficult to understand which qualifications met their business needs, Microsoft created a new framework that keeps the number of qualifications to a minimum whilst still allowing individuals to highlight their particular specialization. The new qualifications are therefore designed to be more relevant and easier to understand, yet still offer the level of distinction needed to be used as a recruiting tool. Critically, what Microsoft refers to as 'lifecycle policies' have also been introduced. This means that certain certifications will now be retired when Microsoft ends its support for the related technology, and others must be updated every three years by taking a 'refresh' exam. The refresh exam ties the student into to a long-term relationship, providing the company with a continuous source of revenue and helping to ensure that their branded credentials do not decline in value over time. According

to Microsoft Learning, the primary reason for introducing these 'lifecycle policies' was to increase the value of the qualification in the market and to ensure that potential employers have confidence that someone who holds a Microsoft Certification is current and engaged with Microsoft technologies.

In India, when the government initially refused to grant NIIT (an Indian IT software and training company) the ability to award degrees, NIIT decided to introduce its own educational programmes and qualifications, including its flagship career program, the GNIIT (a Graduate from NIIT). During the three-year GNIIT program students are put through one year of professional practice at a leading IT organization to help bridge the education-work divide. NIIT has entered into a partnership with more than 100 companies, not only to facilitate this educational requirement, but also sanction stipends to the students on the strength of their contribution to industrial production. This intimate contact with industry also provides a built-in feedback loop allowing the curricula to be continuously updated. For NIIT the quality of its qualification is measured by how successful its graduates are in finding employment. If students are taking the qualification to enhance their careers, a qualification that doesn't enhance their careers will obviously be of no value. NIIT has recently launched a new industry-endorsed GNIIT Program that aims to bridge the existing IT manpower shortage. Again leading IT companies have had direct and extensive involvement in the curriculum design, thereby allowing students to be equipped with industry relevant skills that are tailored to both specific company requirements and standard job profiles. It is interesting to note that while the institutions that are delivering this new generation of qualifications are continuously looking to provide something different, those universities that receive public subsidies continue to focus on

providing exactly the same type and standard of qualification as every other university.

Both Microsoft Learning and NIIT have branded their qualifications with their own company name and logo. Microsoft has dropped the medieval term 'degree', choosing instead to use the more modern 'certificate', thereby making a clear distinction between its qualifications and those supplied by traditional colleges and universities. NIIT however have gone a step further by simply inventing a new name for a qualification (the GNIIT, a Graduate of NIIT) clearly linked with the parent company. It is the GNIIT qualification, not a standard IT degree from a public university, which is becoming the gold standard in Indian higher education. This example clearly shows the potential for the future development of qualifications whose names have not yet been invented, but which have the potential to become national and even global brands within a relatively short space of time.

The branding of qualifications is also significant because it means that the quality and reputation of the qualification is inextricably linked with the quality and reputation of the parent company. Any criticism of the qualification would have a negative impact on the corporate image of the company itself. This places pressure on the provider to continuously maintain and improve the quality of its qualifications by investing in research and development, examining new and better ways of delivery, and in understanding the changing needs of students and industry. For Microsoft Learning and NIIT, the concept of continuing to provide an educational course that has little or no relevance to the world of work is simply not a viable option. Enrolments will decline, revenues will decrease and a loss will be recorded. Either the qualification must be transformed or retired from the market. For

both Microsoft Learning and NIIT, qualification inflation would represent management failure.

Microsoft Learning and NIIT help to shed light on how the profit motive and competition influence the way private companies manage and develop their own qualifications, and also how these companies respond to the changing needs and demands of both students and potential employers. As noted above, for-profit companies will respond to changing customer needs and demands by transforming their existing qualification. This is in stark contrast to many publicly funded non-profit universities that are not only failing to reform their existing qualifications, but have also developed the habit of introducing a new qualification (such as a Masters) on top of the existing degree. While this clearly benefits the university, it also extends the time students have to spend studying, increasing costs to both the taxpayer and the student. Nothing highlights the difference more between the heavily subsidised non-profit sector and the emerging for-profit sector than the following research brief used at NIIT:

*If we (or a competitor) can teach this course in an hour, how can we teach it in half an hour? Or, if it takes us one month to develop this course, how can we develop it in half a month?*¹¹³

The critical point is that companies such as NIIT do not sit around waiting for a Secretary of State to dictate to them what kind of courses they should provide or how to improve the way their courses are designed and delivered. Instead, due to the profit motive and the threat of competition, they just do it.

113 C.R. Mitra, 'The NIIT Academy: A unique 'university' in the making', *Economic Affairs*, Vol. 18 Issue 3.

It is clear that without government intervention there would now be a variety of different, competing, private qualifications providing a variety of different educational experiences – many of which would have much more purpose and relevance to an individual’s future career than the traditional degree. These qualifications are not seen because they have not been allowed to develop. As a result the taxpayer, students and companies across the UK are all left worse off.

4 Conclusions

In *Freakonomics* Levitt & Dubner concluded that conventional wisdom can often be shoddily formed and devilishly difficult to see through. This certainly appears to be the case in higher education, where the conventional wisdom is based almost entirely on *what is seen*, whilst conveniently neglecting *what is not seen*. Although the academic community have excelled in making their case devilishly difficult to see through, by placing *what is seen* alongside *what is not seen* the following conclusion can now be made.

Firstly, there is no evidence to suggest that there is any economic benefit to the nation as a whole from transferring £14.3 billion each year from taxpayers' wallets to students and universities. Secondly, there is also no evidence to suggest that the public benefits associated with spending £14.3 billion on higher education will be higher or somehow better than the public benefits associated with the taxpayer spending £14.3 billion privately. Thirdly, while many are convinced that the annual subsidy is helping to create a more equal and just society, it is impossible to escape the fact that part of this subsidy represents a transfer of income from those on lower incomes to those who will soon be on higher incomes. In short, the government is taxing the poor to help the rich get richer.

Furthermore, it is clear that government subsidies, and the manner in which they have been distributed, have resulted in a significant number of hidden costs and unintended consequences which were not part of the government's or universities' original intention. These include undermining the autonomy and independence of private institutions, crowding out philanthropic donations, the complete disruption and distortion of the pricing system, combining and confusing academic, professional and vocational education, the widespread rationing of university places, restricting private investment from home and abroad, crowding out for-profit institutions and entrepreneurial talent, restricting competition and innovation throughout the whole sector, and qualification inflation.

One hidden cost that is clearly relevant concerns the widespread rationing of university places. As the whole point of transferring the £14.3 billion from the taxpayer to students and universities was to encourage *more* higher education and not *less*, it would appear that this intervention is now having the exact opposite effect to that which was intended.¹¹⁴ When considering all the other costs and consequences of government subsidies and political interference, it becomes clear that they all involve (in one way or another) the distortion and the restriction of the natural growth and development of higher education, making it less efficient and less responsive to the needs of students and businesses.

In particular, the handing out of billions of pounds of public subsidies has either removed or completely distorted the vast network of incentives which would normally help to coordinate

114 For example, there are approximately 150,000 students who have been denied access to university this year, with each willing to pay at least £3,000 per annum to gain some form of higher education qualification. It is difficult to believe that such circumstances would exist if higher education in the UK was an open and highly competitive market, as existing and new suppliers would quickly respond to cater for this unmet demand.

activities throughout the sector. For example, the process of competition, freely determined prices, the profit motive, private ownership and property rights all help to provide incentives which no longer apply in higher education.

Therefore, not only is the £14.3 billion public subsidy to higher education not providing any economic or public benefit, and not only is it transferring income and resources from low income families to those with a higher income, it is also hampering the growth and development of one of the UK's most important service sectors. In short, the subsidy is doing much more harm than good, and can readily be compared to the government subsidies used to support a wide variety of national champions over the previous half-century. Despite arising from good intentions – wanting to create world-class industrial sectors in steel, cars, airlines and telecommunications – government subsidies and attempts to centrally plan the development of these sectors all failed, ultimately achieving precisely the opposite of what was originally intended. Previous experiments with government intervention suggest that the more important a sector of the economy is, the more important it becomes that governments do not attempt to control these activities. Instead, they should restrict themselves to establishing a regulatory framework that will allow and encourage a variety of private institutions to compete and flourish.

By placing *what is seen* alongside *what is not seen*, a number of important questions begin to emerge. For example, how can an industry which receives a £14.3 billion annual subsidy be described as 'an outstanding success story for the economy'? And why is it that the larger the subsidy, the more successful the higher education sector is deemed to be? Doesn't this simply suggest that the costs of higher education are continuously increasing, with the

sector as a whole becoming less efficient? And wouldn't it be better if universities were self-sustaining and didn't need to depend on handouts from the taxpayer?

When you consider *what is not seen* as well as *what is seen*, it becomes clear that politicians and policy experts do not have the luxury of knowing all the relevant facts. Indeed, much of the knowledge which is critical to the everyday working of higher education is widely dispersed and not accessible to external observers. For example, we do not know the aims, aspirations and financial circumstances of every student. Nor do we know what the detailed and very specific training and education needs are for each business across the UK. We have no idea how much each individual student will benefit from taking each different course from each different university, and we have no idea whatsoever about how much everybody else will indirectly benefit from students enrolling on these different courses. We don't know the specific details about where the £14.3 billion is coming from each year to subsidise higher education, and companies have no idea about how much they are contributing or what their contributions are being spent on. We don't know how much students would be prepared to invest in their own higher education or which services they would be willing to pay more for. We don't know what the current limits of state intervention are or what they will be in the future. In fact, we don't even know if universities are supposed to be fully public or fully private institutions. Nor, indeed, are we sure what their primary purpose should be. As noted by Professor Norman Barry (1983), the permanent crisis in higher education in the UK can best be described as a crisis of information.

Writing in *The Guardian* in January 2010, Michael Arthur (chair of the Russell Group) and Dr Wendy Piatt (Director General of

the Russell Group) warned politicians in the UK that they ‘must take a responsible approach to the funding of higher education and recognise that it is one of the jewels in the country’s crown, *worthy of protection* because of the extraordinary value that it brings to our society, international competitiveness and economy’ (italics added).¹¹⁵ This is *what is seen*. *What is not seen* is that this special pleading by powerful interest groups for protectionist policies is centuries old, and completely fails to take into account the unintended consequences of protectionism. In reality, the ‘protection’ of national champions in higher education will only restrict competition, discourage innovation and encourage inefficiency, thereby depriving students of lower prices and greater choice. As noted by Neelie Kroes (European Commissioner for Competition Policy) in 2007, protectionist pressures can and must be resisted: ‘[t]hose who put up barriers, or who don’t want to take them down, need to know that they are acting against the interest of their economy and their citizens’.¹¹⁶ In 2006, the EC Competition Director-General was far less charitable when he described national champions as being illegal, immoral and fat!¹¹⁷

Thus, the more highly people value higher education, the more important it is for the government to restrict all forms of protectionism and instead promote free enterprise and deregulation, which will foster innovation, spur competition, increase efficiency and lower prices. These conclusions reinforce those of Psacharopoulos (2004), who suggests that there is now

115 Michael Arthur and Wendy Piatt, ‘Universities face meltdown – and all of Britain will suffer’, *The Guardian*, 11 January 2010.

116 Speech by Neelie Kroes (European Commissioner for Competition Policy), ‘European competition policy facing a renaissance of protectionism - which strategy for the future?’, St Gallen International Competition Law Forum, St Gallen, 11 May 2007.

117 Speech by Philip Lowe, ‘What is wrong with National Champions?’, Enforcing Competition Law Conference, London, 23 June 2006.

a growing contradiction in Europe between the protected, non-competitive higher education sector, and the drive towards the internal market and international competitiveness. He warns that '[u]nless there is a radical institutional shake-up away from direct state finance and control of universities, academic excellence in the old continent will keep slipping away to more progressive parts of the world'.¹¹⁸

This report also challenges the CBI's definition of higher education as a 'vital public good'.¹¹⁹ Instead, all universities are private institutions and all forms of adult learning, whether formal and structured, or informal and unstructured, are personal and private activities, where the aims and ambitions of individuals are supreme. University students are not a national resource which need to be utilised in order to achieve specific national goals. While higher education may provide numerous public benefits, this simply confirms that the self-interested acts of students will often help to promote the greater good, a fact that deserves to be celebrated and not criticised.¹²⁰ To describe higher education as a public good or a government service is highly misleading, and will only help to justify the high rates of taxation which we are forced to pay in order to subsidise the higher education sector (among other things).

For those readers who are not convinced by these conclusions, Frederic Bastiat recommended a simple way of challenging those who continued to demand public subsidies. Instead of perpetrating plunder through the instrumentality of the law, they should now

118 George Psacharopoulos, *The DICE Report - A Journal of Institutional Comparisons*, December 2004.

119 Stronger Together: *Businesses and Universities in Turbulent Times*, CBI, September 2009, p.5.

120 Getting a job at 18 will also produce numerous public benefits. So will walking to work instead of driving. However, this does not mean that these activities should be subsidised.

be forced to do it directly. In the case of higher education, the government would declare that they were no longer prepared to confiscate money from the public on behalf of the universities, and that the universities must appeal to the public directly. As universities have been happy to demand public subsidies from the rich and poor alike, they should have no problem with appealing to these same people. In principle, this method of raising funds is the same as the existing system, in which universities use the government to transfer funds through the tax system. The key difference is that while one method is voluntary, the other depends on the use of force. Instead of the funds being transferred from the taxpayer to the government and then to higher education institutions, they would now be given directly by the public to universities. This method of raising funds would appear to be much more democratic as it would at least give people a choice of whether they want to make a donation or not.

The ability of each university to collect sufficient funds would depend on their ability to convince people, and especially all non-graduates, why and specifically how they will benefit from making a donation. If universities are correct in their claims that they provide such widespread and remarkable public benefits, then as long as they can provide the necessary evidence, those collecting the money on the doorstep can look forward to a warm and generous response.

5 Policy Recommendations

5.1 A new, limited role for government

A world-class higher education sector of the future will not be planned or directed by central government, nor will it be used to achieve national objectives. Instead, it will consist of a variety of national and international, private, independent, autonomous, for-profit and not for-profit institutions, each with their own specific missions. In this world-class higher education sector of the future, the ends of individual students (and not institutions, politicians or governments) will be supreme, and the government will be restricted to establishing a regulatory framework that will encourage a plethora of different institutions to compete and flourish on a fair and level playing field. The purpose of government in higher education will be to guarantee that students have at their disposal the greatest possible number of educational opportunities of all descriptions. Therefore, the most important responsibility of government will be to promote, encourage and stimulate competition throughout the sector. This means creating the conditions that will allow institutions to pursue their own aims and objectives as effectively as possible.

5.2 Abolish the cap on university tuition fees

A world-class higher education sector in the UK will not develop unless all institutions are free to sell their services at whatever price they choose, and the sector as a whole can enjoy the benefits of a fully functioning price system. The existing cap on tuition fees must be abolished and legal restrictions should be introduced to prevent any future government from re-introducing such measures, which clearly undermine the legal independence of private institutions. Raising the cap would be insufficient for two reasons. Firstly, it would fail to recognise the basic legal right of any private, autonomous and independent institution to control all aspects of their organization. Secondly, it would fail to recognise the extensive hidden costs and unintended consequences of completely distorting and disrupting the pricing system throughout the whole higher education sector.

5.3 Establish full freedom of entry

In the government's latest national plan, *Higher Ambitions*, it states that '[a]longside the development of our publicly funded universities and colleges we also see an important role for fully private providers over the next 10–15 years'.¹²¹ While the report also notes that the government has made it possible for such providers to obtain degree-awarding powers, this is by no means sufficient to establish full freedom of entry, which is critical if a world-class higher education sector is to develop. Whatever the history of the existing regulatory framework involving the Quality Assurance Agency (QAA) and the Privy Council, it is clearly dated and in need of radical reform. It is therefore recommended that higher education should be treated

¹²¹ *Higher Ambitions*, Department for Business, Innovation and Skills, p.104.

like any other service sector of the economy, with new competitors free to enter without first having to seek special permission from a government agency. The word 'university' is simply a generic term which is used to describe an institution which engages in a variety of education and research activities.¹²² In this sense it is no different from similar words such as academy or college. There is no official or agreed definition of what a university is or what a university should strive to become, so it should not be the role of government to dictate who can and cannot use this word. Any institution that wants to use the word 'university' should be free to do so.

5.4 Extend charitable tax benefits to for-profit institutions

In order to help liberate and stimulate the supply of higher education and increase the number and choice of university places and qualifications available, the government should look to create a level playing field and remove all discrimination between non-profit and for-profit institutions. The current practice of giving tax breaks only to non-profit organizations clearly discriminates against for-profit ones, creating an unfair playing field. As noted by Malani and Posner (2007), while there may be good arguments for recognising the non-profit form and good arguments for providing tax benefits to charitable firms, there are no good arguments for making tax benefits available *only* to institutions that adopt the non-profit form.¹²³ The government's primary focus should *not* be on the type of organizational form an institution chooses to adopt, but rather on the nature of the services they provide. Therefore, in higher

122 The word university is derived from the Latin *universitas magistrorum et scholarium*, which translates into 'a community of teachers and scholars'.

123 Anup Malani and Eric A Posner, *The Case for For-Profit Charities*, Working Paper No. 304, University of Chicago, March 2007.

education the law should not link tax benefits to corporate form. It is recommended that the following tax benefits, which are currently offered to charitable non-profits, should be extended to for-profit institutions operating in the same sector:

- exemption from capital gains tax, and from income tax and corporation tax on income other than trading income arising outside the course of carrying on the primary purpose of the institution;
- ability to recover income tax deducted from deeds of covenant and receipts under gift aid;
- exemption from inheritance tax for donors to institutions;
- substantial relief on business rates.

This reform will also discourage institutions from adopting the non-profit organizational form simply to capture the tax benefits, even when this may be the least effective and efficient method of organising their institution.

5.5 In the short term, re-direct subsidies from institutions to students

As noted by Professor Mark Blaug, there is hardly a country in the world that would not be well advised to radically overhaul the way in which they fund higher education ‘so as to make it conform more closely to what are after all rather elementary economic principles of equity and efficiency’.¹²⁴ This statement refers to the hidden costs and unintended consequences of public subsidies being directed towards institutions instead of individuals. If governments are to continue subsidising higher education, then at the very least they have a responsibility to ensure that taxpayers’ money is used

124 Mark Blaug, ‘The Economic Value of Higher Education’, Uhlenbeck Lecture, 1990.

in the most effective and efficient manner possible, and that it is targeted to support those students in genuine need. It is therefore recommended that within the course of the next parliament public subsidies should be re-directed from institutions to students, a reform which will help to place students back at the centre of higher education. The simplest way to achieve this would be to use government funds to subsidise an extended and enlarged student loan programme, which would ensure that poorer students would not miss out on university places simply because they could not afford the fees.¹²⁵ In order to target the taxpayers' money most effectively, applicants for subsidised loans could be subject to a 'maximum loan amount' (calculated as a percentage of their tuition fees) based on their family income. This reform will also help institutions to regain their autonomy and independence from all forms of central government control and interference, thereby allowing universities to organise and plan their own future growth and development. Finally, the government should make it clear that direct subsidies are being phased out across the sector, and that new subsidies will not be granted to any new institutions entering the market. Instead the government should look to offer new entrants a variety of different incentives (see 5.4).

5.6 In the long term, phase out subsidies altogether

This report has consistently made the case that the taxpayers' annual £14.3 billion subsidy to higher education represents poor value for money, noting that it produces no discernable economic benefits and that it often represents a transfer of resources from those with low incomes to those who are (or soon will be) much

125 See Terence Kealey, *Transforming Higher Education*, Adam Smith Institute, 2006.

better off. This can only increase inequality and injustice. As Bastiat noted, ‘what keeps the social order from improving is the constant endeavour of its members to live and prosper at one another’s expense’.¹²⁶ It would therefore be right, over time, to gradually phase out the subsidy altogether. Setting a clear timetable for this reform, and spreading it over 10–15 years, would give higher education institutions the opportunity attract philanthropic donations and corporate sponsorships, and thus build up their own endowment funds. Ultimately, many higher education institutions ought to be able to offer their own ‘needs blind’ admissions programmes, fully supporting poorer students themselves rather than relying on taxpayer subsidies. As this report has pointed out (see 3.4), government subsidy has for many years ‘crowded out’ private donations to higher education institutions in the UK. The reforms recommended above would do much to overcome this problem, and finally put UK higher education back on the path to self-sustainability.

5.7 Encouraging research and development

The only way that the government can encourage business-related research and development is to reduce the burden of taxation on each and every business across the UK. A government will not encourage any R&D by taxing successful businesses and then spending the revenue on unrelated research being carried out in universities. This will restrict and not promote economic growth. It is therefore recommended that all publicly funded, business-related R&D should be phased out over a period of five years. This never has been and never will be the legitimate role of government. That said, Murray Rothbard (1959) outlined a number of initiatives which governments can undertake to *encourage* R&D, including tax

¹²⁶ Bastiat, *Economic Sophisms*, 1845.

credits to companies for contributions to universities for scientific research, tax credits to individuals on income tax for contributions to scientific research in universities, making tax deductible expenses by business in training scientists at universities, making tax deductible contributions by business to individual scientific research, making educational expenses (for science or other higher education) tax deductible on parents' income taxes, and a decrease in corporation tax to encourage more private investment in research and development.¹²⁷

When it comes to all non-business-related academic research (where the primary objective is not wealth creation), if a government wants to subsidise it by taking money from the general taxpayer, including those on low incomes, then so be it. However, it should be noted that there is no economic justification for making such a transfer, and that a percentage of the public funds spent will simply crowd out private funds already being put towards similar research. A future government would be justified in removing itself from this debate altogether and instead demanding that those who carry out the research approach the public directly, rather than expecting the government to collect funds on their behalf. This would at least appear to be a much more open and democratic method of raising funds, and would also constitute the welcome removal of any element of force or coercion.

5.8 An Office of Fair Trading (OFT) market study on higher education

To help protect the long term health of the UK's higher education sector, it is recommended that it should now come under the

127 See Murray Rothbard, *Science, Technology and Government*, March 1959.

remit of the OFT and that a market study should be carried out immediately.¹²⁸ All existing government subsidies and regulations should be examined to see how they impact on the process of competition in higher education, and to see if they provide the best possible outcomes for students and the greatest value for money for the taxpayer. Questions asked of each subsidy or regulation should include the following:¹²⁹

Does the subsidy or regulation directly limit the number or range of suppliers? This is likely to be the case if the proposal involves the award of exclusive rights to supply, procurement from a single supplier or restricted group of suppliers, the creation of a licensing scheme, or a fixed limit (quota) on the number of suppliers.

Does the subsidy or regulation indirectly limit the number or range of suppliers? This is likely to be the case if the proposal significantly raises the costs of new suppliers relative to existing suppliers, of some existing suppliers relative to others, or of entering or exiting an affected market.

Does the subsidy or regulation limit the ability of suppliers to compete? This is likely to be the case if the proposal controls or substantially influences the prices(s) a supplier may charge, the characteristics of the product(s) supplied, or limits the scope for innovation to introduce new products or supply existing products in new ways.

Does the subsidy or regulation reduce supplier's incentives to compete vigorously? This may be the case where a proposal

128 Market studies are carried out under section 5 of the Enterprise Act 2002(EA02) which allows a market-wide consideration of both competition and consumer issues.

129 Adapted from *Government in Markets: Why Competition Matters – A Guide for Policy Makers*, OFT, 2009, Box 7.2, p.25.

exempts suppliers from general competition law, introduces or amends an intellectual property regime, or increases the costs to customers of switching between suppliers.

As with all OFT market studies, the possible results could include the following: enforcement action by the OFT; a reference of the market to the Competition Commission; recommendations to government for changes in the law; recommendations to regulators, self-regulatory bodies and others to consider changes to their rules; encouraging firms to take voluntary action; and finally campaigns to promote consumer education and awareness. The OFT should also report on any competition concerns relating to new draft legislation which is proposed, including the proposed changes to the cap on tuition fees.

