

Annual Lecture of the Council for Defence of British Universities
26th January 2017

Uses and Abuses of Economics in the Debate on Universities

Martin Wolf¹

“Our universities have a paramount place in an economy driven by knowledge and ideas. They generate the know-how and skills that fuel our growth and provide the basis for our nation’s intellectual and cultural success.” Department for Business Innovation and Skills.²

“We will make it quicker and easier for new high quality challenger institutions to enter the market and award their own degrees. A new Office for Students will put competition and choice at the heart of sector regulation”. Ibid.³

“For every complex problem there is an answer that is clear, simple, and wrong”, H.L. Mencken.

The government’s controversial plans for reform of higher education have at their heart two sets of economic ideas. The first set of ideas concerns national wealth and in particular the impact of higher education on the size of the economy over time. These ideas are about the *ends* to be served by the system of higher education. The second set concerns ease of entry of new providers and of access of would-be students: it focuses on the notion of market competition. This then is about the *means* used to guide the system of higher education. I would add a third set of economic ideas, which does not appear in the White Paper, but is also relevant. This concerns the *resources* that should be invested in higher education particularly by the government. It is about the priority to be accorded higher education against other demands on the public purse. An important issue here is how best to inject such public resources. That, inevitably, interacts with the second set, namely the role of market competition.

¹ Associate Editor and Chief Economics Commentator, *Financial Times*, London.

² *Success as a Knowledge Economy: Teaching Excellence, Social Mobility and Student Choice*, May 2016, p.7,
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/523546/bis-16-265-success-as-a-knowledge-economy-web.pdf .

³ *Ibid.* p.6

The question on which I intend to focus is whether these economic ideas are relevant to a debate on higher education.

Some purists would argue that they are altogether irrelevant – that the proper concerns of higher education are beyond the purview of vulgar economic considerations. This cannot be correct. In all modern countries, governments spend a great deal on higher education. They do so for reasons that inevitably include economic ones. Moreover, it is perfectly legitimate for the government to be concerned about questions of student choice, entry of new and innovative institutions and competition among providers. The problem, I would argue, is not that economic considerations are irrelevant, but rather that they are not *the only things* that are relevant. The inescapable complexity arises in balancing economic considerations against other ones and, given that need, in deciding how best to do so.

The lecture will be divided into five sections. The first will concern the ends that higher education serves and the role of universities within it. The second will focus on market competition as a means of guiding the higher education system and allocating public resources. The third will examine the level of resources devoted to higher education and how the cost is shared between current taxpayers, future taxpayers, current students, future students and others. The fourth will assemble these components into a critique of the current approach to higher education and in particular to the use and abuse of economics. The final section will put forward suggestions for an alternative approach that satisfies economic considerations better, while also seeking to meet other important objectives.

1. Economics and the Ends of Higher Education

The government's animating idea about higher education is that it is an essential contributor to success in a "knowledge-driven economy". This is so in two respects: first, higher education provides the skills necessary for people to prosper in such an economy; and, second, higher education provides the know-how upon which the success of such an economy is built. In the government's view, these economic objectives provide a large part of the justification for its support of higher education and intervention within it.

Does this make any sense? The answer, I suggest, is "yes". It is evident that the people of the UK do, for the most part, desire a higher level of prosperity than they enjoy today. True, this goal is not universally shared. But it is, to a greater or lesser extent, put forward by every successful political party. It would be possible for the electorate to choose a party dedicated to zero economic growth, or even shrinkage of the

economy. But, as a matter of fact, no party that has attempted to do so has achieved any degree of success. Moreover, even if the people as a whole did not desire greater prosperity, a great many do. Thwarting that desire seems rather illiberal.

Furthermore, even if one did desire a zero-growth economy, the structure of the economy would need to change, probably radically. This would partly be in response to economic and technological developments elsewhere. It would also be because reducing the use of scarce resources or the damage done by economic activities to the local and global environments necessitates improvements in know-how. The development of the latter depends in turn on the outputs – human and intellectual - of higher education.

The economic objectives of higher education cannot be ignored. Yet it is no less clear that higher education serves other and no less important goals. In the words of Gordon Graham, “impressive though the development of technology has been, the almost equally long-standing human project of understanding both the natural and the social world to the end not of increasing welfare but of reducing ignorance, confusion and misconception, is no less impressive an outcome of intellectual analysis, reflection and inquiry.”⁴ Understanding is an essential component of a flourishing life. Deepening and widening our understanding has also been both the greatest achievement and the defining mark of western civilisation. Our great universities are the institutions responsible for generating and transmitting that understanding. The health of these institutions helps define whether or not this country deserves to consider itself civilised and an active contributor to civilisation.⁵

Higher education should also mold the intellectual character of students. They should emerge not just better informed, but also better able to evaluate evidence, argue and see through the specious arguments of others. Some will have an appreciation of the history and cultural achievements of humanity. Others will understand the law. Others will be steeped in the effort of philosophers to understand what we know and how we ought to behave. Yet others will have learned of humanity’s scientific and technological achievements. Educated people help make society more civilized and politics more purposeful. Education then is for

⁴ Gordon Graham, *Universities: the Recovery of an Idea* (Imprint Academic, 2002) p.72.

⁵ See also Stefan Collini, “Who are the spongers now?” *London Review of Books*, Vol.38, No. 2, 21 January 2016, <http://www.lrb.co.uk/v38/n02/stefan-collini/who-are-the-spongers-now> .

citizenship and for life. Similarly, institutions of higher education not only preserve knowledge, but push it forward. Such knowledge is often useful in utilitarian economic terms. But, as Professor Graham notes, it also enriches those who possess it and the societies in which they live.

The primary institution of higher education is the university. Its name tells us that it has universal ambitions. It cannot, by definition, be narrow and merely professional. Its scope as an institution of learning should be comprehensive. While it may and, in contemporary society, clearly must, serve economic purposes, it serves many others at least as important to the flourishing of the individuals associated with it and to the wider society of which it is part. Indeed, the notion of universality has a global reach. A great university should not serve a country, but humanity. The purposes of these institutions cannot be reduced to the merely economic, even if the economic is among its purposes.

That makes setting up institutions that serve such purposes so difficult. If the aim of an institution is to serve multiple purposes, it cannot be dedicated to a single aim, such as profit. It has to be an independent, self-governing entity, whose managers seek to balance these various objectives as they see fit. It cannot be for any outside entity, least of all government, to impose one set of objectives, though, as a funder, government has a right to ask universities to achieve objectives that matter to it. To preserve independence in what they do, universities also need a degree of independence in their finances. Making that work is one of the great challenges of today. There is no question that the government's new proposals for a market-led system of tertiary education and, in particular, the proposals for a new and powerful regulator challenge that independence and indeed the very notion of the university as an institution. That brings us to our second question: the role of competition in managing a complex system of tertiary education.

2. Economics and the Delivery of Higher Education

The White Paper, *Success as a Knowledge Economy*, repeats the word "competition" 50 times. This then is the animating notion of the proposed reforms. It raises profound questions. How far, in fact, is market competition a desirable or workable system for governing higher education? The answer is that a degree of competition is desirable and even inevitable. But the idea of a competitive market in this sector is flawed: it is neither desirable nor workable. Indeed, the government itself has recognised this by proposing an overbearing new regulatory system.

But that system is, alas, likely to end up promoting not competition, but top-down controls highly detrimental to the purposes of the university.⁶

A “market” for higher education is intrinsically defective, in at least five important respects.

First, education is a classic “experience good”, like health services: in other words, purchasers do not know what they are getting until long after they have consumed it. This deprives would-be “consumers” of the information on which to make a good decision.

Second, employers of the graduates’ services do not know in advance what their employees have learned and can do. They rely instead on the reputation of the provider. They are right to do so. An institution that possesses a first-class reputation will attract first-class students. Since the quality of the students is the most important determinant of the quality of the graduates, this bias of employers is entirely sensible and so self-reinforcing. By virtue of producing more employable and so more prosperous graduates, institutions with established reputations will also attract more private funds and a higher quality of staff. Since entry into a prestigious institution signals quality, students will also be willing to pay more. These additional resources will, in a competitive market, further reinforce differences in quality and reputation. For such reasons, genuine competition among providers is virtually impossible. This is why Oxford and Cambridge remain England’s top universities nearly two centuries after new entrants entered the field.

Third, in a market in which the quality of provision is almost impossible to assess, the price charged is itself an overwhelmingly powerful signal of quality. For this reason, weak institutions will be unwilling to charge less than their competitors, because it will signal their poor quality and so attract worse students and, quite possibly, even fewer students, too. This would reinforce the upward spiral of prices in a competitive market: top institutions charge more because they can; weak institutions charge more because they cannot afford not to do so.

Fourth, since the existence of a provider is itself a signal of success, its failure would severely damage the value of its qualification. The failure of a provider will be particularly devastating for students actually earning degrees. Indeed, it would be so damaging, particularly now that students are expected to borrow substantial amounts of money,

⁶ See Chris Patten, “Leave state control of universities to China”, Guardian, 1 January 2017, <https://www.theguardian.com/commentisfree/2017/jan/01/leave-state-control-of-universities-to-china> .

that such failure would be almost politically inconceivable. For this reason, exit of providers is also extremely difficult to manage.

Finally, given the well-known failures of markets in the creation of human capital, the government quite rightly funds student loans, currently without limits on the number and (apparently) even the qualifications of students, and so the taxpayer bears the risk if students fail to earn enough to repay what they have borrowed. This makes it rational for providers to maximize the number of students and for students to borrow up to the limit. Students are essentially buying a lottery ticket: if they do well in life, they will afford to repay the loan; if they do badly, they will not have to repay. This makes excessive borrowing a rational strategy for students. That, in turn, will create huge opportunities for irresponsible or corrupt providers. If one can eat lobster at other people's expense, one tends to eat too much.

In sum, the market model in higher education is highly defective: market signals are weak, at best; failure of institutions is unacceptable, borrowing is likely to be excessive; and entry by new providers is likely to be by irresponsible and even downright crooked. Reliance on uncontrolled market competition in this sector is likely to lead to highly perverse results: further divergence in quality among institutions; mass default on student loans; and huge scandals involving new providers, particularly profit-driven providers. Not-for-profit entities are more likely to work precisely because they are somewhat less likely to exploit such opportunities. Where markets are defective, forms of governance that do not depend on the profit motive are essential. Some things simply cannot be bought and sold successfully. It is why professional codes in medicine or the law are so important.

Moreover, even if the market model could be made to work in its own terms, it would not ensure the delivery of the wider social, political and cultural purposes of a system of higher education. Some mechanism also needs to be found to ensure high-quality research. The market mechanism would not, of itself, achieve such aims and profit-seeking providers would have no incentive to do so. It is important to note, moreover, that these are aims of the system as a whole. If they are to be delivered, they need to be internalised within most, if not all, institutions. This is impossible in profit-seeking institutions. That, in turn, is why they are not in fact universities, whatever they might be labeled. What makes a university a university is that it does *not* serve purely market objectives. Profit-seeking institutions can be training colleges. But that is quite a different thing.

Given the extreme difficulty of creating a genuinely free market in higher education, the government has to create a substitute. It does so here, as in other cases, by empowering a regulator. This regulator – the Office for Students (OfS) – will have an extremely wide range of regulatory powers: to control entry into the sector; to promote choice and competition; to provide data, analysis and information to the Secretary of State; to develop, publish and operate a “risk-based regulatory framework”; to help widen access for disadvantaged institutions; to assess quality (via its “Teaching Excellence Framework”); to monitor financial sustainability, efficiency and governance of higher education; to be responsible for the “Prevent” programme against extremism; to be the principal regulator for providers that are exempt charities. As the White Paper states, “The OfS will have oversight of the sustainability, efficiency and health of the higher education sector, and as part of its role will monitor the sustainability of individual institutions.”⁷ In essence, this new regulator will manage the UK’s higher education.

If this new regulator is to be effective, it needs power. That it certainly will have. The almost incredible fact is that the new legislation grants the power to the OfS - a body appointed by, and subservient to, the government - to revoke the charters that have historically granted the right to award degrees. In the terminology of the proposed bill: "The OfS may by order vary or revoke an authorisation given to an English higher education provider (a) by or under an Act of Parliament . . . , or (b) by Royal Charter, to grant taught awards, research awards or foundation degrees." Thus, this body would be granted the ability to abolish the right of Oxford and Cambridge universities - two of the greatest universities in world history - to grant degrees. You will argue that it would never dare to do so and you might be right. But the power is quite enough to force such institutions, and certainly those with smaller reputations and clout, into line. Make no mistake; this is a fully-fledged government takeover of the UK's university sector. Anybody who thinks this will end with more diverse, more innovative, more courageous and more independent institutions is simply a fool.⁸

Furthermore, only one of the seven criteria to be used by the Secretary of State in choosing members of the OfS concerns experience of “providing higher education on behalf of an English higher education provider or being responsible for the provision of higher education by

⁷ *Success as a Knowledge Economy, op.cit.*, p.66.

⁸ See Martin Wolf, “UK university reforms are a betrayal of Conservative principles”, *Financial Times*, 2nd September 2016, <https://www.ft.com/content/f39bad38-6b73-11e6-ae5b-a7cc5dd5a28c>.

such a provider”. It would seem to be quite possible for the OfS to have *no* academic experience at board level. The list of criteria for membership makes no mention of the wider purposes of universities, focusing instead on experience representing students, employing post-graduates, promoting choice in other sectors and managing the financial affairs of some organisation. Apart from this, it requires some experience with “a broad range of the different types of English higher education providers” to be present on the board.⁹

A crucial question in judging the ability of this new body to promote effective competition is whether its “Teaching Excellence Framework” could actually measure that highly elusive concept effectively. The White Paper states “The TEF will provide clear, understandable information to students about where teaching quality is outstanding. It will send powerful signals to prospective students and their future employers, and inform the competitive market.”¹⁰ It will do so by assessing universities and colleges on the metrics of graduate employment, student retention and student satisfaction.¹¹ Furthermore on this basis, universities are apparently to be given a gold, silver or bronze rating.

Approximately a second’s thought would demonstrate that none of these metrics would tell one whether a university actually teaches well. Graduate employment will be overwhelmingly determined by the reputation of the institution, as will student retention. Measures of student satisfaction are unlikely to be well correlated with whether they are well taught. Low student satisfaction might merely mean that they are being challenged and tested in ways they find uncomfortable. The truth is that good teaching is always challenging and often uncomfortable. There is no reason to suppose that the majority of students recognises it when they receive it. Many are more likely to prefer unchallenging teaching leading to unjustifiably high grades. Yet that would merely generate a competitive race towards lower standards and so the destruction of one of the main purposes of higher education, which is to sustain and even improve the standards of students over time.

⁹ Higher Education and Research Bill, 56/2, p.70,
<http://www.publications.parliament.uk/pa/bills/lbill/2016-2017/0076/17076.pdf> .

¹⁰ *Success as a Knowledge Economy*, *op.cit.*, p.13.

¹¹ “England’s universities to have medal-style ratings for teaching”, 29th September 2016, Times Higher Education,
<https://www.timeshighereducation.com/news/englands-universities-have-medal-style-ratings-teaching> .

In all, then, the application of the logic of market economics to higher education is extremely problematic. This is so conceptually and in practice. The effort to use pro-competition regulation as a substitute for a genuinely free market is likely to fail and the determination to make it easier for new providers, including profit-seeking ones, to call themselves universities (which they are not) and provide qualification of doubtful quality, at the expense of the taxpayer and gullible students, is highly dangerous. It is a series of scandals just waiting to happen. Just think of Trump University.¹²

The White Paper states: “Many institutions want to gain their own degree awarding powers, and the right to describe themselves as universities. These high quality institutions will help to enhance the world-class reputation of the sector. However the current process for obtaining either degree-awarding powers or university title is long, convoluted, and unnecessarily burdensome for high quality providers.”¹³ Who cares what institutions want? The question is rather whether they should be granted what they want. The statement that these putative universities are of a high quality assumes precisely what has to be proved. The greater likelihood is that they are not of high quality. In that case, the results will be disastrous, not only for their students and the taxpayer, but for the reputation of UK universities as a whole.

3. Economics and Resources for Higher Education

A final economic question is whether the resources devoted to tertiary education are appropriate, both in total and in their direction. It is more or less an unanswerable question. But it is possible to compare spending in the UK with that in comparable countries.

According to the Organisation for Economic Co-operation and Development, the UK spent a total of 1.8 per cent of gross domestic product on tertiary education in 2013.¹⁴ This is slightly above the average for all member countries, which was 1.6 per cent. It is well behind the 2.6 per cent of GDP spent in the US. But it is well above France’s 1.5 per cent, Germany’s 1.2 per cent and Italy’s 1.0 per cent. The important feature of the UK situation is that public spending is just 1.1 per cent of GDP, with the balance coming from private sources. Public spending is

¹² “Donald Trump Agrees to Pay \$25m in Trump University Settlement”, *New York Times*, 18th November 2016, https://www.nytimes.com/2016/11/19/us/politics/trump-university.html?_r=0 .

¹³ *Success as a Knowledge Economy, op.cit.*, p.29.

¹⁴ *Education at a Glance 2016 OECD Indicators*, Organisation for Economic Co-operation and Development, Paris, 2016, Tables B2.1 and B2.3.

1.2 per cent of GDP in France, 1.0 per cent in Germany and 0.8 per cent in Italy. US public sector spending is just 1.0 per cent of GDP and so much the same as that of the UK. Thus UK tertiary education depends on private spending for a much higher share of resources than comparable European countries, but substantially less so than the US.

A salient difference between the UK and continental Europe and similarity between the UK and US is the divergence in quality among higher education institutions. Thus, on one well-known global ranking, the UK has four of the 10 top-rated universities in the world, five of the top 20 and 10 of the top 50.¹⁵ In higher education, the UK is indeed a global superpower. This is a remarkable achievement of which this country should be very proud. It is partly the result of history and partly because of language. But it must also be the result of the way the government has funded research (however unpopular the research assessment exercise may be with academics). The achievements of UK universities are not just of economic relevance, though they are. They are also an important and widely respected indicator of the UK's contribution to global civilization. The elitism of UK higher education is a salient feature. It is one on which views may differ. I welcome it, since only a few elite institutions can be at the global forefront. This provides great benefit to the country now and in the future. In my view, it is a vital national interest that the financial arrangements and regulatory regime enable top UK universities to maintain their status. The resources available to universities from private and public sources and the ability of universities to run themselves independently need to be adequate to preserve these rankings.

The widening of access to higher education in the past few decades has been so massive that some changes in funding were surely inevitable. In 1980, the number of students earning first degrees in the UK was just 68,150; by 2000, this had reached 243,246; and by 2011, it had reached 350,800.¹⁶ This was a rise from just 0.12 per cent to 0.56 per cent of the population. Assume, for simplicity, that the share of gross domestic product spent on each undergraduate had remained constant. Then the total share of GDP spent on all undergraduates would have had to grow almost five-fold. That could not have happened under any conceivable government, given the many other demands on the public purse. Thus, the (probably inescapable) decision to move towards a mass higher education

¹⁵ [http://www.topuniversities.com/university-rankings/world-university-rankings/2015#sorting=rank+region="+country="+faculty="+stars=false+search=](http://www.topuniversities.com/university-rankings/world-university-rankings/2015#sorting=rank+region=)

¹⁶ See "Education: Historical Statistics", House of Commons Library, 27 November 2012, researchbriefings.files.parliament.uk/documents/SN04252/SN04252.pdf.

system dictated both a substantial reduction in spending per student and a need for more private funding, including via a loan scheme, if standards were to be maintained. The important conditions were that such a loan scheme would rule out upfront payments and make repayments contingent on incomes.

A good argument for a loan scheme is also that a degree brings private benefits, particularly a degree from an elite institution, while access will remain unavailable to everybody, because it is not a universal right, as primary and secondary education are. Loans are also a way of indicating to students that higher education is not a free good. That should persuade young people to ask themselves whether it is worthwhile and also to study properly.¹⁷

It is appropriate, however, to ask whether the balance between loans and direct government support for institutions of higher education is now reasonable. One of the objectives of the very large increases in student loans under the previous coalition governments seems to have been to remove a part of what is effectively public spending on universities from public spending. Moreover, the losses on loans are quite likely to exceed current estimates, making the costs to taxpayers greater than are now recognised. Yet a discussion of the detailed operation of the loan system, in the context of the funding of universities, goes beyond the scope of this lecture.

4. An Assessment of the Uses and Abuses of Economics

In the above discussion, I have investigated the role of economics in setting the objectives of higher education, the means of running higher education and determining the level of resources to be invested in higher education. The conclusions I reach are as follows.

First, economic objectives are among the valid reasons for government support of higher education. But they are far from the only valid reasons. There is a danger that the purely economic objectives are becoming overwhelming, at the expense of other political, social and cultural objectives. The richer the country becomes the more it should be able to invest in the latter. Universities are also not solely economic institutions. They have a far broader role. This is why their status as not-for-profit independent and enduring institutions is so important.

¹⁷ The case for greater reliance on loans was laid out by a commission under Lord John Browne of Madingley: *Securing a Sustainable Future for Higher Education: an Independent Review of Higher Education Funding & Student Finance*, 12 October 2010, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/422565/bis-10-1208-securing-sustainable-higher-education-browne-report.pdf

Second, there are huge difficulties with running higher education as a competitive industry. The proof that the government knows this is that it has set up an extremely intrusive regulatory structure to move higher education closer to its market vision. In practice, this regulation is likely to be unworkable in crucial respects. It is also likely to dominate market outcomes. Reliance on self-governing and independent institutions is likely to prove a far better model, in the long run, than top-heavy regulation. Private profit-seeking institutions may have a place in higher education, but they are not universities and should not be given that label. Furthermore, there are real risks of gross malfeasance by such institutions.

Third, the level of resources spent on higher education in the UK is in line with that of its peers, particularly if private resources are taken into account. It is important that this remain the case. It is important, too, that resources be distributed in such a way that excellence is maintained. There may, finally, be some reason for reconsidering the operation and scale of student loans. But the principle is broadly correct, since it imposes some costs on students, is more equitable than tax-funding and provides a more politically acceptable way of maintaining funding.

5. Considerations on a Way Forward

In important respects the problem with the government's proposals on higher education is not that they are too radical, but that they are not radical enough. The use of the market-cum-regulatory model as a means of expanding the university sector, while ignoring the rest of tertiary education, is inappropriate not just because it damages universities, but that it fails to provide an effective system of tertiary education. It makes no sense to encourage such a high proportion of young people to take university degrees. It makes no sense to concentrate government support on students at just one stage of their lives. It makes no sense to starve resources available to the rest of tertiary education.

As Professor Alison Wolf of King's College London (my wife) has argued, we need to think about tertiary education as a whole.¹⁸ In that context, we can see universities for the very special institutions they are, with particular characteristics. But we need to fund other institutions with important training functions, alongside universities. For many people, shorter and more targeted courses will be a better option.

The way forward might then consist of the following.

¹⁸ Alison Wolf, with Gerard Domínguez-Reig and Peter Sellen, *Remaking Tertiary Education: can we create a system that is fair and fit for purpose?* Education Policy Institute and King's College London, November 2016,

First, make loans available, up to a pre-determined limit per person for legitimate educational purposes, for all post-18 year olds, with a much higher upper age limit than now.

Second, encourage the creation of new institutions within the tertiary education system specifically designed to provide different sorts of courses, including two-year qualifications. Such institutions do not need to be universities or provide standard degrees. They may just help people to obtain well-known higher-level vocational qualifications. Assume, in brief, that tertiary education of some kind is going to become universal. Then design such a universal system, accepting that universities as we understand them will be just a part of that system and not necessarily the largest part.

Third, continue to encourage diversity among universities, via research funding. Also, allow universities to charge higher fees, if and only if they can demonstrate needs-blind admission among qualified UK students. Encourage them to raise the money or create the financial system needed to make that possible.

Fourth, encourage transparency on the quality of teaching, but do not pretend that this can be easily measured or ranked. Accept that an essential feature of any worthwhile system of higher education is trust in the ethics of self-governing institutions. Outside regulation and market incentives can never replace this internal motivation.

Overall, higher education in the UK is a success, particularly at the top end. A good conservative principle is to do no harm. Instead, the aim should be to focus attention where things are not going so well. The problems are indeed complex. The government's answer – market competition and a competition-promoting regulator – is simple, but wrong. The determination to stick to this view seems to be the product of a stubborn attachment to free-market ideology where it is far from applicable. The great idea of the independent and self-governing university must be protected. The government needs to think again.