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Executive Summary of the Roundtable on Publicly Funded Education Markets

Annex to the Summary Record of the 67th Meeting of Working Party 2 on Competition and Regulation

3 June 2019

This Executive Summary by the OECD Secretariat contains the key findings from the discussion held during the 67th meeting of Working Party 2 on 3 June 2019.

More documents related to this discussion can be found at

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Executive Summary of the Roundtable on "Publicly Funded Education Markets" held at the 67th meeting of Working Party No. 2 of the Competition Committee of the OECD[1]

Working Party No. 2 of the OECD Competition Committee held a Roundtable on the subject of *Publicly Funded Education Markets* on 3 June 2019. Based on the background paper prepared by the OECD Secretariat, written submissions from delegates, and the contributions by expert panellists and delegates to the discussion, the following key points emerged:

1. Public funding for education is necessitated by the inability of free markets to provide adequate education services. However, publicly funding education services should go hand in hand with creating incentives to create services that are efficient, innovative or responsive to users' needs. Publicly funding education markets offers the prospect of competitive incentives being used to deliver the services that pupils and students need, rather than the services they can afford to show a willingness to pay for. Advocacy by competition agencies can help to develop market mechanisms that deliver those goals.

Left to their own devices free markets in education result in underinvestment in education and human capital. This results in lower productivity and lost taxes. It also makes it impossible to achieve important policy objective that voters have bestowed upon governments, such as equality of access to a good standard of education. It is also important to recognise the huge importance of continuing adult education and retraining programmes. Market failures in these services are no less acute than in school-age and university education, and the impact of increased globalisation and automation have made the funding and design of these markets key public policy priorities (not least to help ensure that interventions by competition agencies have the desired effect on the economy).

However, publicly funding education services may not be enough, and schools, universities and colleges may need to be incentivised if they are to provide services that are efficient, innovative and responsive to users' needs. One option is to incentivise them by setting performance targets and regulating to drive up the minimum standard. Most OECD countries have adopted this regulatory approach to guarantee minimum standards. However, they have turned to choice, competition and market mechanisms to empower users, and incentivise educational institutions to raise their ambitions to match those of staff by seeking to deliver more than the regulated minimum.

By publicly funding education, governments successfully break the link that free markets create between student's ability to pay and their demand, and ensure instead that the service that a market mechanism provides is based on need. While the evidence to date is not sufficient to recommend that competition be adopted on a widespread basis in education services; positive findings support continued exploration. In particular, it would appear that when designed carefully, competitive incentives can contribute to achieving the important public policy objective of equality of access to high quality education, rather than

[1] This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion at the roundtable, the delegates' written submissions, the panellists' presentations and the background note.

contradicting it. Such a contribution helps to secure the legitimacy of competition as a public policy tool in education and hence allows it the opportunity to increase efficiency.

Competition is therefore a delivery mechanism - not an objective in and of itself. There is therefore a particularly strong role for knowledgeable and nuanced advocacy by competition agencies that does not simply involve advocating for more competition, less regulation, and lower barriers to entry. In some cases, agencies have been active in advocating against anti-competitive distortions that policymakers and regional governments have proposed, and in favour of pro-competitive reforms. This has extended to the use of powers to challenge in court anticompetitive proposals made by regional authorities. It has also included advocating for the introduction of an independent regulator with a remit to facilitate the type of competition that helps achieve public policy goals.

2. There is a trend across the OECD towards increased competition for student choice, though there remain challenges in making these choices meaningful. The information that is given to students to inform their choice, and the structure of payments that schools, universities and colleges receive, will together determine what competitive incentives can achieve and hence are important areas for competition agencies to advocate upon.

There is a trend across the OECD towards the increased use of competition for student choice. Where informed student choice is feasible it is likely to be more effective at improving services than competitive tendering. However, it requires that students have access to comparative information on services; that students are aware of the difference in the services available at the point at which they choose, and recognise the costs of switching once they have chosen; and that they would consider choosing differently if poor quality were provided. Many countries therefore provide comparative information on outcomes across different institutions, while some provide choice advice and subsidies for those students wishing to travel further for better services.

The type of information that is given to students and the payments that are offered to providers will also help to determine the type of competitive incentives that are created. For instance, payments that depend on the degree of socio-economic and cultural diversity within a school (including clawbacks from institutions that enrol an excessively narrowly defined group of students) will help to incentivise providers to compete to attract a diverse group of students. Similarly limiting information on the unadjusted achievements of students in each institution, and instead highlighting information on the value-added by the institution will help to incentivise students to select on the basis of expected value-added, and not the investment value of the signal that is sent by having attended a particularly institution.

3. For competition to improve outcomes, the price that providers are paid needs to be at a level that incentivises providers to work to attract students. Where prices are unregulated and set by providers this can create a topping-up problem that risks conflicting with the public policy objective of equal access, and thereby delegitimising competition as a policy tool. Where prices are regulated, the risk is that the ministry or regulator sets prices that make it unprofitable to compete for certain groups of students, for example those with more complex needs.

Where prices are not regulated, and are topped up by users (with the help of state subsidies), providers can charge higher prices for educating students with more complex needs but can also charge higher prices to users that are willing to pay more to top-up the service they receive. Publicly funding such a system will therefore not help to address educational inequalities. Competition agencies that advocate for the removing of restrictions on top-ups as a ‘pro-competitive’ measure therefore risk bringing competition as a policy tool into conflict with the public policy objective of equal opportunity. In contrast, those agencies that support the prohibition of top-ups on publicly funded services, will be able to then advocate for pro-competitive measures that help policymakers to achieve their goals of equal access to a more efficient education service.

In most publicly-funded systems, prices are regulated. This is because there is a concern that inadequate quality information will lead to competition to cut costs without reference to the impact on quality and value. However, where prices are regulated there is a risk that regulators will set prices at which it is unprofitable for an efficient provider to enrol some students. In such cases the incentive for the provider is to attract the most profitable students (by cream-skimming or cherry-picking), and to discourage or refuse to enrol those that are unprofitable. Underfunding the enrolment of students with complex needs is therefore likely to result in poor services for those students, not only because a school's ability to provide a good service will be impaired by inadequate funding, but also because the school would have an incentive to discourage other such students from choosing to enrol. Careful price regulation based on reliable data can therefore prevent the emergence of such perverse incentives.

4. Education is consumed by students, but it is also an investment good. In this context, if there is formal or informal selection then there are likely to be cream-skimming effects. Asymmetric public service obligations can be expected to distort competition and harm the interests of students. Similarly, there is scope for schools and universities to abuse dominant positions by raising rivals' costs and foreclosing their ability to compete for high performing pupils or students.

Education can be a consumption good because users value the consumption of it and enjoy learning. However, it is also an investment good because investing in education (or human capital) creates value for the user in other markets, for instance the labour market. Moreover investment in education has both substantive value, in that it increases students' productivity and hence value in the labour market, and a signalling value, in that education helps to identify or reveal a student's 'type' to employers in the labour market. This is important given the asymmetry of information on which potential employees are high value, and which are not (since all claim to be high value types).

The value of the signal that an education provides, and in particular an education from a specific school or university, means that those schools and universities have an incentive to compete to offer students the best signal that they can show to potential employers. One way for schools and universities to send a strong signal is to compete by adding as much value as possible to improve the productivity of each student that enrols. This is desirable for policymakers. However, another way that a signal can be sent is to enrol only those students that endow an institution with what it wants. In some cases, this might be future financial endowments, but in others, it might be the ability to offer other students better networking opportunities or a better reputation. Indeed, this is perhaps an easier and more reliable strategy for schools and universities, since it does not require them to innovate to find ways to provide a better education. Moreover, employers ultimately care only about the performance of the employee and care little about how much they have improved their skillset during their education. Where permitted to do so, schools and universities can therefore be expected to invest in competing to offer a stronger signal to employers by selecting the best students, rather than competing to offer the best education. Policymakers looking to use competition to improve the quality of education have therefore prohibited selection and required schools with excess demand to operate lottery-based admission systems (see for instance charter schools).

In addition to the risk of competition on undesirable factors (e.g. grade inflation), there is also a risk that competition will be restricted or distorted as a result of a lack of competitive neutrality. For example, asymmetric universal service obligation regulations might permit certain schools to select students (and hence to refuse to enrol those they do not wish to admit), while obliging other schools to enrol any student that chooses to. In such cases, selective schools will select the most profitable students, and leave higher cost, less profitable students to attend schools with a universal service obligation. This will increase the costs of rival non-selective schools, and restrict their ability to offer high performing students the same value signal as selective schools. In each case, the competitive constraint that non-selective schools impose on selective schools will be weakened. Similarly, since many students at non-selective schools will be unable to choose to enrol at a selective school, the selective schools will not provide a strong competitive constraint on non-selective schools. As such, both types will have an incentive to provide a poorer quality education than they otherwise would have.

A similar effect is likely even where all providers are able to select. For instance, while in many countries all universities are able to select students, a university that has a historic reputation that gives it a large excess demand each year, will be able to select and enrol those students that maximise the network and reputational effects that the university will then offer to other students. In this sense, education markets that allow selection will tend to tip towards the creation of local market power. The fact that universities holding this power often choose to cap their capacity and earn monopoly rents through non-financial payoffs, should therefore not blind us to the existence of this market power. Indeed, these network effects are likely to act as a powerful barrier to entry by potential rivals. In such circumstances, a dominant university that acts to protect that dominance by selecting students and thereby raising its rivals' costs and limiting their ability to compete, might be considered to be abusing its dominant position.

5. If competition is to improve the quality of publicly funded education services then successful schools and universities must be able to expand. Indeed, in some countries, there is considerable merger activity between schools, and this has the scope to reduce competition in local markets. Since these acquisitions do not appear to have been reviewed by competition agencies, and a number of countries have identified cartels in the sector, there would appear to be scope to consider greater scrutiny and merger control in the education sector.

For competition to lead to better publicly funded education services it is important that successful schools and universities are able to expand. However, there appears to be a maximum efficient scale beyond which dis-economies of scale kick in. This discourages successful schools from increasing the number of pupils on a single site. Addressing regulations that restrict those schools or universities that have demonstrated an ability to add value from opening additional sites can therefore help additional students to choose those schools.

Another way for successful schools to expand is through mergers and acquisitions. For example, when schools with considerable autonomy begin to fail, mergers and acquisitions offer a way for them to exit the market without creating disruption for students. The growth of school chains is also a visible trend in some countries. These mergers into chains offer potential benefits in terms of allowing effective and efficient schools to grow and spread good practice throughout the chain, as well as allowing access to economies of scale. However, forced acquisition of failing schools by other ineffective schools, or ineffective chains, seem unlikely to offer any benefits, and so restrictions on those that are allowed to acquire additional schools can help avoid the need for more costly future bailouts.

For competition agencies, the relevant questions that are posed by the creation of these school chains will include whether there is a change of control, and whether the size of local school markets is such that there is a possible loss of competition. Relevant factors that might affect substitutability and hence the strength of the competitive constraint that is lost might include not only distance, but also factors such as gender balance, religious affiliation, speciality, and the ability to select (either by regulation or in practice). In combination, these factors suggest that school markets are likely to be both local, and in many cases highly concentrated in their nature.

Cartels have been found and punished in both university and private schools markets. Accusations of explicit or tacit collusion have also been made and it has been suggested that price caps provide obvious focal points for such coordination. Looking beyond price-fixing there is also considerable scope in education markets for geographic market-sharing agreements, or for non-compete agreements between universities, either on the recruitment and retention of staff, or by imposing anticompetitive restrictions on students ability to apply to rival universities. Given these cartel cases and the scope for anticompetitive mergers there would therefore appear to be considerable scope for competition agencies to play a more active role in delivering better quality more efficient education services through merger control and enforcement action in the sector.

6. While barriers to entry can prevent some new providers from accessing education markets, barriers to exit in the form of bail-outs for failing providers can entirely undermine competition within the market. Developing a reliable administration process for ineffective education providers is therefore an important part of effectively advocating for the removal of access to such bail-outs.

In many countries, there is little appetite for allowing profit-making firms to compete to provide publicly-funded education services. Indeed, it remains unclear that doing so would increase the effectiveness or efficiency of services. For example, there is little confidence that information on quality is sufficient to deny profit-making firms the opportunity to cut costs in ways that damage quality but which cannot be easily observed by students. Moreover, even with good information on outcomes it might take 5 years or more for such cost-cutting to have an impact on performance measures. Indeed, in practice where profit-making firms have been allowed to enter the schools market they have failed to demonstrate the innovation that might have been hoped for, while their introduction appears to have led to predictable gaming of the system, for instance through grade inflation where lax regulation permitted it. The majority of countries therefore rely on a combination of state-owned and charitable foundations, while allowing those that wish to purchase advice or consultation services from profit-making firms to do so. The advantages of adopting market mechanisms therefore can and should be separated from the case for or against introducing profit-making into the delivery of these services.

More important than entry by new providers is the facilitating of exit by inefficient incumbents. While some countries have developed systems to facilitate the transfer via acquisition of such schools and universities, it is more common that inefficient poor quality providers are bailed out and protected. However, such protectionism can be damaging as it undermines the incentives for more effective schools and universities to compete to expand. Advocacy that recognises and addresses the public policy requirement that exit must be managed smoothly and not interrupt the education of students, is therefore more likely to be successful with government.