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School Vouchers and Influence Costs

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It is relevant to point out the backdrop of the publication date of Milton Friedman's *Capitalism and Freedom*. Upon the Soviet launch of Sputnik in the late 1950s, American politicians and educators perceived an inferiority in intellectual performance among American citizens. The proposed and implemented solution was for increased government spending in higher education and increased spending at state and local levels in primary and secondary schools. In the face of this statist agenda, Milton Friedman reiterated his 1955 proposal for a less socialist program of financing education—a voucher program where students would be given tax monies to spend on education as they and their parents saw fit. That government would be otherwise out of the picture in education and that educators would have to be competitive with each other in responding to the desires of students struck most at the time as a radically extreme libertarian idea.

As I will argue in this paper, the voucher proposal was not and is not extreme and certainly is not libertarian. It might be fairly characterized as radical in that it departs in many important ways from the orthodoxy of what is called public education. Its chief economic benefits derive from the reduction of what is known in the economics literature as influence costs. However, a voucher system does not eliminate all or even most influence costs. Further, a voucher system perpetuates the mistaken notion that education is a public good (in the economic sense of that term) and thereby forms an impediment to optimal educational investment by the American people.

A Fundamental Mistake

Friedman writes in Chapter 6 of *Capitalism and Freedom*:

> A stable and democratic society is impossible without a minimum degree of literacy and knowledge on the part of most citizens and without widespread acceptance of some common set of values. Education can contribute to both (1962).

He further argues that such education has positive "neighborhood effects" that cannot be isolated as to whom the benefits accrue and, therefore, that justifies government's involvement in mandating and financing education.

This argument for government oversight of education is unpersuasive. First, the common values of a free society must be anterior to government. To entrust government with the responsibility of promoting the values necessary for freedom is naive at best and downright dangerous at worst. Government, like most organizations, never tries to limit itself, but always seeks to expand its influence. If it is given the power to shape a society's values, one can be reasonably sure it will promote those values most beneficial to itself and most inimical to freedom. Stable and free societies are almost entirely dependent on respect for private property and publicly-funded and controlled education undercuts such respect.

Second, 'neighbor effects' or positive externalities in certain behaviors do not justify government support. One elementary example is neighborhoods themselves. The value of my neighbors' houses goes up when I improve my own, but that certainly doesn't justify a forced subsidy from them to me. Surely there are positive externalities to a well-fed citizenry, but that is no argument for government financed grocery stores. And behaviors that produce positive externalities are frequently capitalized sufficiently by individuals. For example, if one's education makes a person more valuable in society, then one recoups the cost of education through selling this value. So long as the price system allocates compensation to those who produce social benefits, then educational benefits can be capitalized by individuals. The market, therefore, gives the right incentives to individuals for investment in education (Friedman, D., 1993).

Friedman comes close to making the error that most do in referring to education as a public good. It is not. A public good as understood by economists is one that has two main characteristics. One, is non-exclusion where once the good is produced it is available to anyone whether or not they have paid for it. Examples would include national defense, a legal system, and a mosquito abatement program. Education is not such a good, because it is perfectly possible to turn people away from school who have not paid.

The second characteristic of a public good is non-rivalrous consumption. For public goods, one's consumption does not affect the consumption opportunities of others. Receiving a radio broadcast has no effect on the ability of others to receive the broadcast. With education, however, any effort by one student to make use of educational resources, such as desk space, teacher attention, books and materials does preclude others from such use.

Because education is both excludable and rivalrous, it cannot be correctly labeled a public good. It, therefore, does not require government funding and control and, in fact, such funding and control undermines the value and values of education.

Influence Costs and Vouchers

In Chapter 1 of *Capitalism and Freedom*, Friedman writes:

> In a capitalist society, it is only necessary to convince a few wealthy people to get funds to launch any idea, however strange, and there are many such persons, many independent foci of support. And, indeed, it is not even necessary to persuade people or financial institutions with available funds of the soundness of the ideas to be propagated. It is only necessary to persuade them that the propagation can be financially successful; that the newspaper or magazine or book or other venture will be profitable. The competitive publisher, for

> example, cannot afford to publish only writing with which he personally agrees; his touchstone must be the likelihood that the market will be large enough to yield a satisfactory return on his investment.
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> In this way, the market breaks the vicious circle and makes it possible ultimately to finance such ventures by small amounts from many people without first persuading them. There are no such possibilities in the socialist society; there is only the all-powerful state.

In these two paragraphs, Friedman anticipates by more than two decades one of the more productive lines of economic theory. Paul Milgrom began articulating a concept for economic analysis of 'influence costs' in the 1980s, culminating in a 1988 publication in the *Journal of Political Economy* entitled, "Employment Contracts, Influence Activities, and Efficient Organization Design." The fundamental notion of Milgrom's paper is that there are costs attendant to any increase in centralized control because participants inevitably care about the decisions that the central authority can make and so spend time and resources trying to influence the authority's decisions. Effective organizations (or writ large, effective economies) are those that are structured to reduce influence costs.

A simple example illustrates this concept. It is of no consequence to an airline which flight attendants are on which flights. However, flight assignments are likely to be of great concern to the attendants. If assignments are handed down from some authority, then it seems likely attendants might engage in costly activities to influence the authority. A simple solution to this problem (and one that many airlines use) is to put routes up for bid and have competing bids resolved through seniority.

The airline flight attendant example is perhaps a small one, but think of the amount of government lobbying activity that takes place in the United States. Very bright and very talented people are spending very valuable time and resources to influence government officials. The opportunity cost of such activity is very high for a society.

Influence costs can be particularly significant in government schools. What will the curriculum be? Will creationism be acceptable; will evolution be acceptable; must only one or must both be taught? Sex education: Should there be any and if so, how should it be taught? Who decides on what is taught in history and how it is taught? What books are to be allowed? What behaviors (dress code, respect for teachers, etc.) can be mandated and what punishments will be permitted for those who misbehave? All these questions and more have to be answered by all schools, government and private. Those involved in education care deeply about these questions. As a school system becomes more centralized, the influence costs rise as participants (students, teachers, parents, administrators, and citizens) spend time and effort trying to get the authority to answer the questions as the participants see best.

Friedman's voucher plan seems at first glance to greatly reduce influence costs. If his plan were adopted, public schools would be privatized and authority would likely become more decentralized. Such decentralization would reduce influence costs in two ways. One, a competitive market in schools would develop which would cater to students and parents and require teachers and administrators to be good at their jobs; two, the sphere of influence activities would be greatly reduced due to the market nature of private versus government schools.

The Limits of Vouchers

On the surface it seems that a voucher system would greatly reduce influence costs and improve education through competition. But lessons from higher education may be instructive regarding vouchers. Although higher education in the U.S. is not funded through vouchers explicitly, there is some element of the voucher system in place. Subsidized student loans, tax credits, and subsidized tuition at state (and private) institutions are, practically speaking, forms of vouchers. What has been the result of such financing?

Meckling (1985) addresses the pre-eminence of American higher education with regard to the rest of the world. His argument concludes that the main reason for this relative excellence is historically private funding of American colleges and universities in comparison with those in Europe and elsewhere. His main point is that how you finance an institution will affect its focus. And government funding of any sort mis-directs the proper focus of education.

Note that university presidents and other officials in higher education spend a great deal of time and effort lobbying government for various forms of financial support. Take as one example the National Science Foundation (NSF). It awards taxpayer money to various scientific efforts. But influence costs are apparent in several ways with regard to the NSF. First, there is the issue of the NSF budget, which will be lobbied for within and without the NSF. Second, the administration of such funding will involve additional lobbying. Third, the NSF grants themselves are awarded through a very complicated and multi-step procedure, involving substantial effort on the part of applicants and reviewers. Would not foundations with non-taxpayer funding find better and more effective procedures for advancing scientific research? Historically, the Rand Corporation and the Mayo Clinic are two examples of such private sector success. And the funding of such foundations is the result of commercial activity or the competition for voluntary giving rather than the coercive expropriation of taxpayer wealth.

And note the odd behavior at colleges and universities: Administrators spend time and effort encouraging faculty to spend time and effort in seeking external funding. The influence costs within the academic institution are thus magnified because of the reliance on government support. Such funding probably does little to advance real discovery and research and the process of seeking it clearly detracts from the teaching mission of these institutions.

There is more that can be said about the funding of higher education, but note the conclusion of the Commission on Financing Higher Education published on November 19, 1952:

> We are convinced that it would be fatal were federal support to be substantially extended. Power means control. Diversity disappears, as control emerges. Under control, our hundreds of universities and colleges would follow the order of one central institution, and the freedom of higher education would be lost.

The experience of the last 50 years in higher education has borne out that Commission's worst nightmares. Why would we expect any fewer problems with a voucher system in primary and secondary education? Lee (1986) makes the telling point regarding vouchers that as a political construct only a voucher program acceptable to the educational professionals currently in control of education policy, the entrenched political interest, is a possibility. A hen house of a design approved by foxes will be the predictable political result.

The fundamental problem with government funding of any kind is that it requires government involvement and oversight that creates and augments influence costs. How much should a voucher be? What curricular requirements will be mandated for eligible schools? What personnel requirements will be mandated? All of these issues and more under a voucher program would be settled through the political process, not through the market place. Private schools would find a significant increase in the involvement of the public sector in their activities. In effect, influence costs would not be eliminated through vouchers, but merely moved to another level.

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