Key Policies for a Competitive Education Industry

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There=s a lot of talk about competition in primary and secondary (K-12) educationCwe desperately need itCbut little[1] or none currently exists in the United States.[2] This article aims to clarify the nature of competition as it could apply to K-12 educationCincluding the significant differences between genuine competition and limited rivalryCand to describe the policies that would foster genuine competition in K-12. It=s an important issue, because unless we know when genuine competition exists, how to foster it, we will continue to malign market forces by conducting pointless experiments that focus the policy debate on cosmetic partial measures that are limited escape valves rather than working reform catalysts. Without an overhaul of the public debate, Aa nation at risk@[3] will not get the transformation of the K-12 system that rightly tops[4] the national political agenda.

Competition=s key requirements

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[1]Perhaps in the Edgewood District of San Antonio, Texas.

[2]For discussion of competition in past education systems, including the pre-1840 United States, see Andrew Coulson, *Market Education* (Brunswick, NJ: Transaction Press, 1999).

[3]National Commission on Excellence in Education, *A Nation at Risk: The Imperative for Educational reform* (Washington: U.S. Department of Education, 1983). Similar language is in the AEducation as a National Security Imperative@ chapter of the February, 2001 *Road Map for National Security: Imperative for Change*, The Phase III Report of the U.S. Commission on National Security/21st Century (Washington, DC): 38-46.

[4]It was the #1 political issue until the >9-11= terrorist attacks. Concerns about the K-12 system even arise in the national security recommendations of prestigious presidential commissions: *Road Map for National Security: Imperative for Change*, The Phase III Report of the U.S. Commission on National Security/21st Century (Washington, DC: February, 2001): 38-46.

Genuine competition is a much more powerful reform catalyst than the rivalry that may arise from limited forms of school choice. In a truly competitive setting, prices respond to market forces, the government doesn=t discriminate, and market share is contestable. ContestabilityCwhich means that new firms can contest market share easilyCis the critical element. Numerous sellers, each with tiny market shares, are desirable and likely in K-12, but not essential. Economists have shown that contestability with only a few sellers at any one time, though not as good as many buyers and sellers, can still yield quite competitive behavior (Morrison & Winston, 1987; Borenstein, 1992; Baumol, Panzar, & Willig, 1982). According to that research, producer interest in keeping the number of actual rivals from increasing is almost as effective at keeping prices low and quality high as a large number of actual rivals.

Contestability and nondiscrimination

The first two key elementsCcontestability and nondiscriminationCoverlap. The public school monopoly on tax dollarsCdiscrimination against private school usersCseverely reduces contestability by putting private schools in a very precarious financial situation. Public schools don=t charge tuition, so private schools must compete with a >free= service, usually with less money per student. Private schools must charge parents a significantly higher price for a service that usually costs less to produce[5] than what >public= schools offer. The difficulty of that feat keeps private schools= market share extremely low. That any non-elite, nonsectarian private school can survive is quite remarkable. I know of no other industry in which so many producers can get consumers to pay for a cheap substitute for something available to them for free. To establish competition, private schools must be relieved of the burden of that difficult feat. Therefore, to achieve contestability and

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[5] Per pupil spending of private schoolsCabout $3,116 (1993-94 data) according to the National Center for Education StatisticsCwas much lower than >public= schools= per pupil expenditures. Both >public= and private schools underestimate their costs, but the underestimates are much larger for public schools (see Myron Lieberman and Charlene Haar, *The Real Cost of Public Education* (in press).

non-discrimination, the public funding allocated to a child must not depend on who owns the school the child attends.

Another key requirement is enough well-informed and mobile consumers to impact the financial viability of producers. A small number is often enough. Competitive industries can contain many poorly-informed, low-mobility participants. The minimum number of well-informed, mobile consumers depends on the relative importance of fixed costs; costs incurred regardless of sales. In high-fixed-cost industries, a firm=s financial viability hinges on a relatively small number of informed and mobile buyers.

Price change

Price change is the final critical element. Prices must reflect constantly changing production costs, and buyers= changing priorities. Price change eliminates shortages and surpluses and it prompts appropriate industry expansions and contractions. For example, price increases eliminate shortages by prompting a quick supply response, and by attracting additional producers. The rise in the number of producers eventually reverses some or all of the price increase, and that prevents over-expansion.

The current education system lacks that critical price movement mechanism because the 88% of K-12 children that attend public schools pay no tuition. And that affects what private schools can charge. The two largest voucher programsCMilwaukee and FloridaCand many prominent proposals curb price change by banning private money Aadd-ons;@ private schools cannot cash vouchers unless they accept them as full payment. To establish the critical price movement mechanism, schools must be free to charge whatever they want without jeopardizing the parents= eligibility for direct government support, or indirect support through vouchers or tax credits.

To better understand the effect of banning add-ons, consider this example. Suppose a voucher is worth $3,000. That amount of privately provided education would cost a family nothing beyond the school taxes they pay. If families can add-on, $3,001 worth of education services would just cost a family another $1. But if they can=t add-on, they would have to forego the voucher and pay the entire $3,001 tuition. Such a huge jump in outlays for just a small change in services creates a price cap at the voucher amount. Universal parental choice without the right to add-on (pay tuition with a voucher plus private funds) would keep services that cost somewhat more than the voucher amount off the market. It would limit private spending to after-school programs, tutoring, and premium schooling (i.e., elite prep schools). In other words, $3,000 vouchers for everyone, combined with a ban on >add-ons,= would eliminate school choices costing somewhat more than $3,000, and greatly lower the demand for those costing much more than $3,000. For example, there probably would not be any $4,000 services, and very few $7,000 services. Many of the families that would buy $7,000 services by supplementing the $3,000 voucher with $4,000 of their own money probably would not pay the full $7,000 themselves if add-ons were illegal. Instead of paying an extra $7,000 for an additional $4,000 worth of schooling, many parents would use the voucher at a school that would accept it as full payment, and then pursue additional education informally by investing in tutoring, summer programs, or educational software.

Discussion

Discussions of K-12 reform often associate Acompetition@ with policies that only foster quite limited rivalry. One such policy introduces the profit motive through the partial privatization of school management. The profit motive reinforces the effects of competition, but without competition, pursuit of profit can be counterproductive. Privatization of school management does not introduce contestability or price change. It only changes a government-run monopoly into a government-regulated private monopoly. And differences between private management and private ownership create potential problems. Renewal uncertainty tempts managers to cut corners and maximize short-run profits. Under-investment is likely because the management contract might not survive long enough to recover investment outlays.

Contestability also requires a high degree of certainty about underlying authority and demand. Entrepreneurs are much less inclined to enter an education market if the political support and the legal framework for the key elements of the market are shaky. Because they create uncertainty about long-term demand, pilot voucher programs, and typical privately funded voucher programs, will not stimulate major investments. Parents value continuity. For that reason, parents are less likely to choose a new school if its survival could depend on political decisions that have no relationship to school quality or parent preferencesCa frequently reported charter school issue.

A competitive education industry will tend to expand its territory. Suppose that a county is the first in its region to adopt a competitive education industry. Families suffer no penalty for moving there. Non-discrimination does not reduce the public funding of K-12, and add-ons would increase total K-12 funding. That, and lower administrative costs, would create funds to attract better teachers and motivate them with significant merit raises. Because the public funding per child is the same regardless of who owns the chosen school, potential immigrants that prefer private schools will realize a large financial gain. Likewise, county residents that prefer private schools would suffer large losses if they left the area. Those rewards and penalties exist even without convincing >evidence= that competitive pressures improve educational outcomes. The development of such evidence will attract parents who prefer government-owned schools. Since local governments compete for residents and tax base (Tiebout, 1956), the authorities in adjacent counties may react by establishing their own competitive education industry.

Specialization is a critical outcome of competitive markets. Buyers differ greatly, so sellers must specialize to capture a share of the market. Because competitive pressures force educators to specialize in what they do best, specialization also raises productivity. Since educators would specialize in different topics,[6] aptitude levels, and teaching styles, including use of technology, we=d also improve productivity by achieving a much better match between educators and the interests and limitations of children. Compare that to the

[6]There is some subject area specialization by >public= schools, mostly by so-called magnet schools that children are not assigned to.

status quo. We stifle specialization by assigning children with diverse interests, talents, and needs to a single neighborhood school.[7] You can not assign children to specialized schools. Schools can not specialize unless parents have a wide range of school choices. No wonder that educators struggle in vain to be Aall things to all people@ (Nelsen). That means one size fits all for required classes and lots of elective courses and extra-curricular programs, often taught by people lacking the appropriate specialized knowledge. Even within the severe constraints of the current system, specialization is already a common denominator of success. Successful principals Adesign their curriculum around the unique strengths and expertise of their staff@ (Carter).

[7]According to 1993 data from the national center for Education statistics (NCES), 80 percent of the Grade 3-12 student population attends the public school they are assigned to. NCES did not say why its data excluded grades K-2, but the percentage will be higher at those grade levels.

The likely demise of slow-to-change, unpopular, schools raises the issue of bankruptcy. Bankruptcy is an important factor because it is an easily monitored, relatively objective indicator of failure, and the possibility of bankruptcy strengthens the incentive to keep up with customers= changing priorities and minimize costs. But the school bankruptcy issue could be a political liability without some careful explanation. Bankruptcies are rare in the public sector. Public schools typically close only because of structural obsolescence or population decline. We need to point out that bankruptcy=s absence from the public sector sustains many inefficient and obsolete government programs, including many bad public schools. In the private sector, bankruptcy performs the critical task of shifting resources, like teachers and school buildings, from obsolete and inefficient managers to new and growing school enterprises and other businesses.

School bankruptcies would not be as disruptive as some people probably think. Bankruptcy would not always force a change in the ownership of school assets. The Legal Information Institute points out that: AUnder Chapters 11, 12, and 13 [of the Federal Bankruptcy Law], a bankruptcy proceeding involves the rehabilitation of the debtor to allow him to use his future earnings to pay off his creditors.@[8] It gives debtors time to restructure. The bankruptcy laws can produce improvements without ownership or managerial changes.

In a competitive education industry, bankruptcies probably would not cause many abrupt closures. Children would face sudden moves only in extreme cases. Schools facing a bankruptcy that requires more than restructuring would usually just get new managers. Even sudden mid-year changes will not necessarily disrupt classrooms. New owners have strong incentives to cater to the existing student body=s unique abilities and interests. That means that new owners are unlikely to abandon the existing faculty and staff, or subject and methodological specialty areas, except where there is a clear link to the bankruptcy.

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[8]The Legal Information Institute web page www.law.cornell.edu/topics/bankruptcy.htm) quotation refers to the chapters of the Federal Bankruptcy Statute (Title 11 of the U.S. Code).

The public can establish safeguards against abrupt shutdowns. The authorities could publish critical financial data so that parents can avoid financially shaky schools. Something like bank deposit insurance could prevent mid-year shutdowns. It would mean making schools post a bond or buy insurance sufficient to run the school until the school year ends. Insurance companies would audit schools and signal which ones are risky through refusal to issue a policy or by demanding high premiums.

All of the current voucher, tax credit, and public school choice programs (including charter schools) widely touted as experiments, lack key requirements of competitive settings.[9] Limited, restriction-laden voucher programs like Florida, Milwaukee, Cleveland, and the privately funded programs only slightly reduce the level of discrimination against private school users. Among the public programs, only the Cleveland program (very small, and on the brink of legal extinction) allows parents to combine private and public dollars to pay tuition. However, the small size of the program, and the low-income eligibility criterion severely limits the likelihood that add-ons will support the wide range of private school offerings that would otherwise result from specialization and market-determined pricing.

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[9]It is too soon to say whether the Edgewood program (San Antonio, Texas) contains enough of the key requirements.

Since Aa nation at risk@ needs K-12 transformation, small programs do not qualify as Atentative procedures@ (Webster=s definition of experiment). They allow relatively few children to change schools, but they leave the broken system intact. That is not an attack on policy entrepreneurs that pursue limited quick fixes. The programs named above aren=t the problem. The problem is the unrealistic hype attached to them. Unjustified claims about the imagined effects of non-existent competition (Fiske and Ladd, 2000)[10] could seriously diminish the political feasibility of reforms actually capable of creating genuine competition. They probably already have. The current parental choice debate is almost exclusively about relatively insignificant measures that leave the status quo=s essential elements intact.

Policy essentials and options

The key elements of a competitive education industry described above, and the political imperative of limiting the debate to the minimum requirements of competitive markets, point to several policy essentials and options.

The policy essentials are:

1. State and local public funding of K-12 instruction must be child-based so that parents= school choices are the only determinant of each school=s share of state and local tax dollars. Some people will argue that the requirement is overstated; that market forces would not be greatly weakened by the use of some additional criteria to determine a school=s instructional funding. That=s debatable. But even if factors other than parental preferences would have negligible direct effects, opening the door to additional criteria would distort market forces. Worst of all, departures from a well-defined, easily

[10] For example, Fiske and Ladd=s publication, which is actually an imaginary tale since New Zealand public school choice system which was the subject of the book does not contain any of the key elements of a competitive education industry.

understood equal share standard create uncertainty and incentives to spend resources to lobby for a greater share of public funds.

2. Each child=s share of state and local K-12 instruction spending should be the same whether the child attends government-owned, private nonprofit, or private for-profit schools. Again, many people will allege that this policy essential is overstated. And the same rebuttal applies. Non-discrimination is a well-defined standard without a politically stable, well-defined substitute.

3. There must be no barriers or disincentives to private spending on K-12 instruction. Families must have the right to supplement their share of public funds with private funds (>add-on@) whenever they want to buy more schooling than the public funds will buy.

4. To focus the political debate on the public funding allocation method, the child-based state and local public funding of K-12 should begin at the current K-12 funding level.

5. As required by existing federal law, federal K-12 funding must provide supplemental public support to special needs children on a case-by-case basis.

6. There must be a minimum enrollment to qualify an educator to receive public funding to educate children. This will further deter extremist schools[11] and fraud, and stop families from earning income by educating their own children.

[11]States already have the authority under compulsory attendance laws to define Aschool,@ and thus the ability to deter education practices that preach hate or violence.

7. For any direct payment method or a voucher program, there must be a way to verify the enrollment of each school. This may also be necessary for refundable tax credits. Without accurate enrollment records, homeschoolers may fraudulently claim the credit. Many readers will wonder why homeschoolers should not legally get the same credit that goes to school users. The reason is that it would encourage some couples to have a large number of children. The chance to earn income by educating a large family would greatly increase the cost of a tax credit, and it could cause a population explosion. The change in the taxable income deduction per dependent that resulted from the 1986 federal tax reform act was much smaller than a likely K-12 tax credit, an the 1986 change caused a baby boomlet (Whittington, Alm and Peters, 1990).

The significant policy options are:

1. There are at least three possible public funding methods: direct payment, vouchers, and tax credits. Direct payment based on enrollment is fine, but then it might be illegal to include church-run schools. Participation by church-run schools isn=t essential, but I believe that it is desirable. Therefore, if churches can receive public funds indirectly through vouchers or tax credits, those methods are better than direct payment. A universal voucher program meeting the conditions described above is a viable option, but I prefer a fully refundable tax credit. Vouchers have higher administrative costs, a larger regulatory expansion risk, and undeserved, but still real, excess political baggage. With a tax credit, schools would bill parents, and the government only has to issue checks to families with K-12 credits larger than their tax liabilities.

2. Public funding per child can vary by region and the child=s age. Private school tuition is typically higher for high school grades than for elementary grades, an indication that it costs more to educate older children. Therefore, more public funding for, say, tenth graders than second graders may be appropriate. Likewise, the authorities may decide that regional cost differences warrant regional differences in the public funding per child.

3. The authorities will have to decide how much of current government spending to allocate to instruction and how much to allocate to the administrative requirements of a child-based K-12 funding policy. Note that those requirements are vastly smaller than, and different from, the administrative requirements of the current system. With child-based funding, the administrative requirements include enrollment verification, fund disbursal, and monitoring and enforcement requirements of regulations and potential fraud.

As long as there are no restrictions on private K-12 spending (Aadd-ons@), the political tug-of-war over the appropriate age- and region-based differences, the issue of instructional vs. administrative spending will not be too damaging.

4. The government must determine its role as an information provider and data generator, including standardized testing requirements and content. Test score comparisons will still matter to some parents, but with the specialized schools of a competitive education industry, such data will not matter as much as they do with the comprehensive uniformity that now dominates public schools. Testing may become private as specialized schools struggle to achieve highly valued, demanding certifications from professional associations and other types of accrediting entities that will probably arise from common specialization areas. The government could then collect, tabulate, and distribute the private test data.

5. The definition of school: states would have to define >school= to determine eligibility for public K-12 instructional funding. The definition that states use to enforce compulsory attendance laws will probably serve that purpose adequately, but there will be pressures to add regulations. They must be resisted. Personnel qualifications, textbooks, curricula, food service, and transportation services are among the issues competitive pressures will resolve quickly and efficiently. Market forces also correct mistakes quickly. Choice and tolerance, not regulation, are the answer to persistent conflict over uniform school policies. Regulations would be counterproductive for

the same reason as the demand for themCthe ever-changing controversy over what the rules should require. The other reason is that regulation of school policies would hinder the relentless pursuit of improvement that characterizes competitive markets.

6. Public funding could include an add-on requirement. For example, public funding could provide a maximum amount per mainstream child or maximum percentage of tuition and fees per child whichever is less. People choose more carefully when they have to spend some of their own money; historically, a common denominator of effective school systems (Coulson, 1999). It is also a way to deflect arguments that public schools will have less money per student once all K-12 children share the existing public K-12 dollars. However, there are also potential political disadvantages. An add-on requirement forces public school users to spend more than they do now, and enforcement will require government monitoring of each school=s tuition and fees.

Summary and conclusions

The frenzied pursuit of reform that followed the 1983 publication of the Presidential Commission=s AA Nation at Risk@ report failed to produce significant K-12 improvements. Slightly improved standardized test scores realized by some states probably mask additional decline that has accompanied attempts to pursue improvement through progressively greater micro-management of teachers. Failed efforts to wring acceptable results from the public school-dominated K-12 system resurface again and again in what amounts to a AMore-of-the-Same-Harder@ strategy. As a futility of modifications to the current governance and funding systems become increasingly evident, interest in system transformation will grow, and competition is the cornerstone of an effective reform catalyst.

To achieve transformation through competition, there needs to be a greater awareness of the essential elements of a competitive education industry. The essential policy change is an end to the discrimination against private school users. With that change, existing public K-12 funding is more than enough to establish a booming K-12, competitive education industry. It can thrive even if state or federal supreme courts decide that church-run schools can not receive public funds, even indirectly through parent-controlled tax credits or vouchers. The current church dominance of the private sector just means that such a court decision would slow down the transition from the status quo to a mature competitive education industry.

A major barrier to free enterprise in K-12 education is the current parental choice debate=s pre-occupation with small, restriction-laden programs that leave intact the current tiny menu of unacceptable choices. Resistance to change and low expectations have bred a narrow-mindedness that jeopardizes the competitive education industry vision. We can celebrate the current programs for the modest escape valves that they are, but we must shift the public debate to policies and transition strategies that can transform the system. Competitive systems have key elements that usually can not arise incrementally. Experience from past competitive education industries (Coulson, 1999) and the genuine competition that exists in most of our economy demonstrates that those key elements are indispensable.

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