

ALIGNING INSTITUTIONAL INCENTIVES WITH GOOD SOCIAL OUTCOMES

Talk to University of Sydney Association of Professors Symposium, Friday, November 23, 2018

Ross Gittins, Economics Editor, The Sydney Morning Herald

The other day I noticed a tweet that was in the form of an incomplete statement, to be finished by the hearer: At the end of this course, students will be able to . . . The tweet suggested Socrates' ending would be "know that they know nothing". The education administrator's response would be "I'm sorry, but that is not a measurable learning outcome".

I want to give you an economic journalist's perspective on the symposium's question of What should Universities be? Economic journalists take a great interest in budgets, particularly the federal budget. Politicians are eternally conscious of the public's unending demand for more government spending on 101 worthy projects, but – at least in the politicians' belief - the public's steadfast reluctance to pay the higher taxes needed to fund that higher spending.

By the late 1980s, the Hawke-Keating government realised that free university education – which had failed to achieve its goal of significantly increasing the proportion of students from low-income homes – could no longer be afforded, particularly because it involved taxpayers who had not benefited from higher education contributing to the education of students from better-off families gaining, at no tuition cost, an education that brought them significant private benefit in the form of higher lifetime incomes. In what I regard as one of the most important applications of applied micro economics in our times, Professor Bruce Chapman, of the ANU, invented what is properly known as the income-contingent loan, but we remember as HECS, an ingenious way of requiring students to contribute part of the cost of their education, without discouraging students from poor families from going to uni. The introduction of HECS and the advent of full-fee paying international students were the first steps in reducing the burden of universities on the federal budget. The Howard government greatly increased HECS and universities greatly increased their reliance on revenue from international students, with the government taking every opportunity to reduce its share of the cost of a growing local student population. Unis were freed to set their own fees for post-graduate degrees and diplomas, and have turned this into a "nice little earner". If you remember, at one stage the Howard government even allowed unis to charge a full fee to local undergraduate students whose marks fell not too far short of the cut-offs applying to Commonwealth-supported places, until the incoming Rudd government put a stop to the practice.

The one development which didn't fit the feds' trend of expanding the universities' revenue-raising capacity as a way of reducing their own contribution was Julia Gillard's decision to relinquish the feds' control over the number of funded undergraduate places for local students and allow them to be "demand driven". This was part of a plan to greatly increase the proportion of school-leavers going on to higher education. To universities that had been under so much pressure to generate their own funding, this was like the opening of a great safety valve. The following years saw a huge increase in the number of undergrad places. My guess is that it was the second-tier and regional unis that did most to increase their numbers. When the demand for places had exceeded the government-limited supply of places, universities had used high ATAR cut-offs to select the brightest available students. Admittedly, when a policy decision is made that a higher proportion of each cohort should receive a university education, a reduction in entry standards is inevitable. But the abandon with which some universities dreamt up reasons for admitting students with limited

qualifications has been, to coin a phrase, unedifying. It didn't disguise the unseemly rush for money from the government's open coffers.

What followed with the election of the Abbott government was, with hindsight, eminently predictable. The increased cost to the feds of demand-driven places was unsustainable, and the only answer was to reduce the proportion of feds' contribution to undergrad places, while allowing the universities to cover this loss by deregulating fees. To me, it was impossible to not to see where this move was intended to take us: as unis progressively increased their fees, the feds would progressively reduce their contribution to teaching costs until the cost of university teaching was completely off the federal budget, leaving only the cost of the HECS loan scheme and the cost of research funding. As the Group of Eight used their pricing power to really ramp up their fees, changing students a premium for their greater social status and more centrally located and better-appointed campuses, and using that premium to subsidise their research effort, it might be possible for the feds even to cap their contribution to research costs. The more the sandstone unis ramped up their fees, the more scope they would create for second-string unis to raise their fees, even if to a much lesser extent. The claim that market forces would prevent unis from abusing their pricing power was naive economics. The existence of HECS meant the price students were paying was government-subsidised and of uncertain size over the distant future. Universities of lesser reputation or regional location would be unlikely to compete by charging a lower price than other second-string universities because the difficulty of knowing the quality of their degrees before actually undertaking them meant students would use price as an indicator of quality. Thankfully, fee deregulation was blocked by the Senate. The Coalition government has since tried to make savings in other ways, finally succeeding in abandoning the demand-driven system and capping the number of Commonwealth-supported places. I'm not sorry to see an end to the demand-driven approach. It created the perverse incentive of encouraging unis to get more funding by further lowering their entry standards.

What this story amounts to is that, for the past 30 years, successive federal governments have worked to get university funding off the federal budget. Although it's possible to point to snippets of economic fundamentalist thinking – eg competition between universities would prevent them from abusing their right to set their own fees – there's been no government report that has recommended such a policy and I don't believe it's the result of some grand "neoliberal" conspiracy. Rather it's been an undeclared, unplanned, backdoor privatisation of the universities. I believe it's happening in an ad hoc way as Treasury and Finance have looked at each year's budget and tried to find ways of reducing the deficit by saving money here and saving a bit more there.

Because it's not genuine privatisation – because universities remain government-owned agencies, subject to quite a high degree of regulation by the federal Department of Education and Training; because university education is in no meaningful way a market in which profit-making universities compete against one or two formerly government-owned unis – this backdoor privatisation has left universities rudderless, with no boss to report to, no simple objective of maximising profits, no one telling them what their objectives should be. University leaders have found themselves overwhelmingly preoccupied with a task their academic careers have not prepared them for and for which there's no precedent to follow: raising sufficient revenue to fund their ever-growing establishments. Little way of knowing how to find the best trade-off between the funding imperative and the maintenance of traditional standards of teaching and research, let alone such airy-fairy notions as the pursuit of knowledge just for its own sake.

Little wonder then that so much of universities' present performance is open to criticism. My greatest fear is that a university degree is not as valuable, not as rigorous, not as life-changing and

life-preparing as it used to be. That gaining a university degree has become more like being processed through a sausage factory, with ever declining staff-student ratios, with lecturers who have far less personal interaction with their students, lecturers who are rewarded for gaining research funding by being give money to pay some part-timer to take their place in lectures (another perverse incentive), with videoed lectures placed on websites so that students don't have to physically turn up, with assignments and exams that are easier to pass, with essay assignments that aren't marked with comments as conscientiously as they should be, with informal quotas on how few students may be failed and informal rules on how vigorously widespread plagiarism should be detected and punished.

I worry that the period of demand-driven open slather, combined with overly ambitious parents and universities' eternal quest for more funding, has led to too many not-particularly-academically-inclined young people going to uni when they would have been better served going to TAFE.

I worry that, heightened by the Howard government's perverse attack on compulsory student unionism, universities have become places you visit between your employment obligations, not places you hang around most days, debating incessantly with your friends.

I worry that too many international students are paying big bucks for degrees than haven't taught them as much as they should have. Like many others, I worry that universities have become too dependent on revenue from international students, particularly from China. In the longer term, this revenue source will diminish as Asian countries get more universities of their own. In the short term, unis could be hard hit by a sudden deterioration in relations between Australia and China.

I worry that universities have become bad employers, mistreating young people seeking an academic career by keep them on successive short-term contracts when they should be given permanency. I worry about professors who take advantage of their young helpers' job insecurity.

I worry that in their newfound search for a lodestar, universities have settled on key performance indicators, debatable measures of academic effort and excellence and, above all, international university rankings, most of which value research excellence more highly than teaching excellence. The trouble with relying on such "metrics" is that they too often create perverse incentives, and are too easily gamed, not just by staff but by university leaderships themselves. I accept the value of the universities' contribution through research. But research effort whose primary objective is to gain promotion, or to get the university a higher league-table ranking, may not be research that's worth taxpayers paying for.

So, what can be done to better align institutional incentives with good social outcomes? One good outcome is students who've been taught to think critically, whose outlooks and values have been broadened beyond those they got from their families, and who have been left with inquiring minds and a love of learning. Another good outcome is research motivated by a genuine spirit of inquiry, rather than as a means to the end of promotion or higher ranking on league tables. Yet another good outcome is vice-chancellors unafraid to proclaim to the world that a primary objective of their university is knowledge for its own sake. Vice-chancellors willing to argue that humans have always been an inquisitive animal, and that the richer we become the more we can afford to indulge – yes, indulge - our curiosity. That learning is an end in itself, not just a means to better jobs and higher incomes.

How can we better align incentives with good social outcomes? For a small start, politicians should stop encouraging the unhealthy obsession with league tables by boasting about well we're doing. I believe it is reasonable to require students to bear part of the cost of their tuition (at present, about

half), particularly because of use of HECS-style concessional arrangements for repayment. But I don't believe it's reasonable to require students, rather than taxpayers, to contribute to the cost of university research. The Productivity Commission has already pointed out that students whose course puts them in the top tier for HECS payments – such as law and business students – are being required to make such contributions. The Productivity Commission has also pointed out that the universities' preoccupation with international league tables is also motivated, at least in part, by a desire to attract more international students and be able to charge them higher fees. This is not healthy.

The logical implication of all I've said is that federal governments should abandon and reverse their covert ambition to get universities off their budget. Government's should bear more of the cost of universities, and be braver in asking voters to pay higher taxes as a consequence. Politicians would be assisted in this if there was greater confidence by voters that youngsters going to university were being well taught. Inevitably, any significant increase in public funding is likely to come with strings attached. At least in principle, I'm not sure it would be a bad thing for universities to have their owner and paymaster give them a clearer indication of what the community requires universities to be. In practice, however, greater central regulation may not be as sensibly done as we would like.