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The Hidden Costs and Unintended Consequences of Government Intervention in the UK Higher Education Sector

James B. Stanfield

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james.stanfield@ncl.ac.uk

http://egwestcentre.com/

www.facebook.com/egwestcentre

@JamesStanfield1

Newcastle University

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Abstract: This working paper examines *what is seen* and *what is not seen* in the UK higher education sector. In contrast to the conventional wisdom, there is no compelling evidence to suggest that public subsidies to higher education have any economic benefit. Moreover, once its hidden costs and unintended consequences are taken into account, government intervention in higher education is doing far more harm than good, and is holding back the development of one of the UK's most important service sectors.

Key words: higher education, profit motive, qualification inflation, tuition fees, crowding out

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1. INTRODUCTION

The French political economist Frédéric Bastiat (1801-1850)[1] previously noted that the task of examining public policy was complicated by the fact that government interventions often produced not just one immediate and visible effect, but a series of hidden costs and unintended consequences which accumulate over time. To help explain further, Bastiat used the parable of “The Broken Window” which begins when a boy accidently smashes the window of a baker’s shop. The baker subsequently contacts the local glazier who replaces the window and is paid for his services. After covering his costs, the glazier then spends the rest of his money in the local community, generating further income for the butcher, tailor and inn keeper, who also then spend their extra income elsewhere, and so on. After the window had been broken a crowd of onlookers appeared on the scene and although they had sympathy for the baker, they concluded that at least the breaking of the window would have a positive effect on the local economy. After all, what would happen to the glazing industry if no one broke any windows? Based upon this assumption they also conclude that the breaking of more windows would help to generate further growth and prosperity.

However, according to Bastiat this interpretation fails to take into account *what is not seen.* For example, before the window was broken the baker was planning to buy a new pair of shoes. Therefore, while the glazier may have benefited, this was at the expense of the shoe maker. The economic growth caused by the glazier spending his money in the local economy would therefore have occurred anyway and so it doesn’t represent any additional growth but simply a transfer of income from the shoemaker to the baker. *What is also not seen* is that instead of fitting a new window into a new house, the glazier’s efforts have now been redirected towards replacing the broken window. Finally, despite spending some of his money, the baker is left with just a window and has been denied the satisfaction of a new pair of shoes. The baker is therefore clearly worse off and as he forms part of the local community it soon becomes clear that the breaking of the window was not good for the local community after all.

The importance of recognising *what is not seen* in public policy is encapsulated in the law of unintended consequences, which recognises that the actions of individuals, organisations and governments will always have some unintended consequences (both positive and negative) which were not part of the actor’s original intention. This suggests that even when some well intended government policies achieve their stated goals in the short run, they may still be doing more harm than good in the long run, after the hidden costs and unintended

[1] Bastiat’s collected works have recently been republished by the Mises Institute (www.mises.org) in the US and can be downloaded for free or a hard copy purchased online for $44.

consequences have been taken into account. A devastating example was when Chairman Moe had the bright idea of ordering everybody to kill sparrows in order to prevent them from eating the rice. Unfortunately, the killing of millions of sparrows subsequently led to an explosion in the insect population, which then proceeded to eat all of the rice plus all other crops resulting in mass starvation. Chairman Mao had failed to take into account *what was not seen*, which was the impact of his intervention on the insect population.

Identifying *what is not seen* in public policy is also the subject of a 2009 Office of Fair Trading report 'Government in Markets', which suggests that '[o]ne of the biggest challenges for policy makers is to identify unintended consequences of regulations'[2] and to minimise their potential impact when designing new legislation. As noted by John Fingleton (Chief Executive, OFT), what makes the policy making process so difficult is the fact that the 'damage to competitive markets is often initially hidden, only becoming obvious over time and can be extremely difficult to remove or reverse'.[3]

This approach was used to great effect by Levitt & Dubner in their 2005 bestseller *Freakonomics*, which attempted to reveal what the authors described as 'the hidden side of everything'. Their book was based on a number of ideas including: the suggestion that the conventional wisdom is often shoddily formed and devilishly difficult to see through; that experts often use their informational advantage to serve their own agenda and finally the idea that incentives matter. Each of these ideas will also play a key role in helping to identify and understand *what is not seen* and *what is not seen* in the UK higher education sector. In the sometimes confusing world of higher education, the reader is also advised to follow Levitt & Dubner's advice "ASSUME NOTHING - QUESTION EVERYTHING**".**

While much of the current national debate on higher education has focused on *what is seen*, the immediate benefits of government spending and national planning, it has tended to neglect *what is not seen*, which are the hidden costs and unintended consequences of these interventions which have accumulated over time. This report therefore aims to shed light on some of these hidden costs and unintended consequences in the hope that it will help to inform the ongoing national debate on what a world class higher education system will look like in the future.

2. WHAT IS SEEN IN HIGHER EDUCATION

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[2] Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, p.23.
[3] Government in Markets, Speech to the Regulatory Policy Institute, Oxford by John Fingleton, Chief Executive, OFT, 7 September 2009.

There are currently 169 publicly funded higher education institutions in the UK, with 109 recognised as universities[4]. Four are ranked among the top ten in the world, with a further five ranked in the top fifty. With only 1% of the world's population, universities in the UK produce 7.9% of the world research publications and 12% of all citations, which is second only to the US. The fact that the UK is now the second largest destination (after the US) for overseas students, confirms that UK has a world class reputation in higher education.

Previous government legislation and public investment in higher education has received widespread support from across the political spectrum because of the remarkable benefits which higher education promises to bring. For example, Universities UK estimates that those who graduate from university with a degree will earn approximately £160,000 more over the course of their working lives than those with two A levels. Graduates have also been found to be less likely to smoke or become obese and they also have lower levels of depression. On top of these private benefits, higher education also promises to deliver substantial public benefits including increased tax revenues, reduced crime rates, an increase in charitable giving & community service, more social cohesion and a decreased reliance on government support. Universities are also recognized as being important economic assets in themselves, with the sector's economic output estimated to be over £59 billion a year, an increase of £10 billion since 2004. Universities also directly provide over 314,600 full time equivalent jobs and over 353,900 additional jobs are generated throughout the economy through secondary effects. In total this represents approximately 2.6% of full time employment in the UK in 2007[5].

According to the Higher Education Funding Council of England (HEFCE), universities in the UK have never been more important because they 'unlock the talents of students; promote shared values; extend opportunities to an increasingly wide range of people; drive local and national economic growth; provide a highly skilled workforce; create innovative world beating products and services; create jobs; and support communities'. HEFCE is therefore confident in concluding that '[w]e have a world class higher education system, delivered through autonomous universities and colleges responding to market and policy incentives in ways that fit their mission, location and aspirations'[6]. This view is supported by Professor Steve Smith (President of Universities UK), who in September 2009 described UK universities as 'unquestionably one of the UK's outstanding international successes'. According to Professor Smith, the nations future now depends on a successful university sector and only

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[4] Higher Education in Facts and Figures, Summer 2008, Universities UK.

[5] The Impact of Universities on the UK Economy: Fourth Report, Universities UK, 2009.

[6] Understanding Institutional Performance, Advice to the Secretary of State for Innovation, Universities and Skills, HEFCE, 2008, p.3.

universities can provide a route to that future 'since they are the most effective ways to promote social mobility, to ensure social cohesion and to create both the jobs for the future and a work force with the skills that the knowledge economy requires'[7].

After widespread consultation, the government published its national plan *Higher Ambitions* in November 2009, which outlines how universities will be expected to change and adapt to meet all future challenges and maintain their world class status. Despite the success of the UK's higher education sector, complacency is not an option and a number of outstanding issues still need to be addressed, including: how to improve access to students from low income families; what to do with the cap on tuition fees; how to increase private and philanthropic investment and finally how to ensure that courses remain relevant to the world of work. This very brief account of the state of higher education in the UK represents (more or less) the prevailing consensus and is based entirely upon *what is seen.*

3. WHAT IS NOT SEEN IN HIGHER EDUCATION

3.1 Why the £14.3 billion annual subsidy?

According to the prevailing consensus, higher education and economic growth are closely linked and so increasing public subsidies to higher education will help to increase wealth and prosperity for all. Together with the numerous benefits enjoyed by each individual graduate, higher education also promises to deliver substantial public benefits, which according to Professor Nicolas Barr (LSE) provides 'a cast iron case for taxpayer support'[8]. It has also been suggested that in an economic downturn the government can help to stimulate economic growth by increasing public investment in higher education. According to Professor Smith (Universities UK), this is not special pleading for more public subsidies but 'an evidence-based, logically constructed argument''[9]. This is *what is seen*.

However, *what is not seen* is that there are many activities which are closely linked to economic growth and there are many individual activities which also benefit the wider community, but this is not a sufficient reason to justify forcing other members of the community to subsidise them. If the taxpayer was expected to subsidise everything that was useful, then where would it stop? In Bastiat's story of the broken window (see Introduction), the crowd of onlookers appeared on the scene after the window had been broken and they

[7] Professor Steve Smith, President, Universities UK, Keynote speech to Members' Annual Conference, Edinburgh University, 10/09/2009.

[8] Professor Nicolas Barr, Higher Education Policy Institute seminar on The Operation of the Market in Higher Education: Opportunities and Constraints, Experience and Ideology held at the British Academy on 14 January 2009.

[9] Professor Steve Smith, President, Universities UK, Keynote speech to Members' Annual Conference, Edinburgh University, 10/09/2009

were therefore inclined only to take into account *what was seen* - which were the benefits which accrued to the glazier and the rest of the community following the unfortunate accident. In the story of the broken university, economists have also appeared on the scene after the government had started to subsidise higher education and as a result they too have tended to focus on *what is seen*, which are the expected benefits captured by each individual student and the local community.

For example, in a 2006 report published by Universities UK, universities are described as 'independent business entities'[10] with an income of £16.9 billion. This was found to be generating £45.1 billion of UK industry output (in 2003/04) and providing over 280,000 jobs directly, with an additional 301,000 being generated throughout the economy. The report concludes '[i]t is evident from the findings of this report that such [public] investment has a direct economic impact on the UK economy'[11]. In the follow up report published in 2009, the income or 'total revenue earned' by universities in 2007/08 was now £23.4 billion which generated over £59 billion of 'output', therefore confirming 'a rapid growth in economic impact'[12]. Direct employment had also increased to over 314,600, with an additional 353,900 jobs being generated throughout the economy, representing approximately 2.6% of full time employment in the UK. The economic activity generated by university expenditure is also described as 'substantial' and 'very important at the macroeconomic level', which is comparable to legal services and larger than the pharmaceutical and aircraft industries in the UK. According to Professor Steve Smith (President of Universities UK), these figures show that the higher education sector is 'one of the UK's most valuable industries', and unquestionably 'an outstanding success story for the economy'[13]. This is *what is seen.*

However, *what is not seen* is that if public policies are examined only from the point at which public funds are spent, then from this limited point of view everybody benefits. For example, when a government spends £14.3 billion for whatever reason, then those receiving these funds are clearly going to benefit by some degree. Experts are then tasked with attempting to measure or guess how much everyone benefits by this additional spending and then this is identified as a positive gain or an addition to the national income.

However, *what is not seen* is that because the government has no money of its own, for every £1 it spends it must first remove at least £1 from the taxpayer's wallet. Therefore,

[10] In a speech on the 24th February 2009, the Secretary of State John Denham stated that '[u]niversities and colleges themselves are successful businesses locally and globally and are often large employers. . . .. Indeed, other sectors might learn from the success of higher education as a business'!

[11] The Economic Impact of UK Higher Education Institutions, University of Strathclyde, Universities UK, March 2006, p.3.

[12] This report was produced for Universities UK by Ursula Kelly, Donald McLellan and Emeritus Professor Iain McNicoll of the University of Strathclyde.

[13] Universities UK Media Release, 04/11/09.

when the government spends £14.3 billion on higher education, taxpayers are now forced to spend at least £14.3 billion less in their local community[14]. While the report gives the impression that the £14.3 billion spent on higher education and the economic activity which it generates, represents an addition to the national income, it fails to recognise that it only represents a transfer or a relocation of income and resources. While it may be obvious that universities, students and the community are going to benefit from a £14.3 billion subsidy, it should be equally obvious that the taxpayer and the community will also be £14.3 billion worse off. It is therefore meaningless to claim that £14.3 billion public investment in higher education has had ‘a direct economic impact on the UK economy’ or that its impact has been ‘substantial’ and ‘very important at the macroeconomic level’, without also acknowledging that by removing £14.3 billion from the taxpayers wallet, will also have a substantial economic impact on the UK economy which will also very important at the macroeconomic level. As it is impossible to predict if more economic growth will be generated if the £14.3 billion is spent by the taxpayer in the local community or if it is spent on higher education, then there is no evidence to show that there will be any economic benefit from the annual £14.3 billion subsidy to higher education[15].

The problem of focusing only on *what is seen* can be further highlighted if the government decided to increase the public subsidy from £14.3 billion to £100 billion. We can only assume that Universities UK would now publish a new report showing a dramatic increase in ‘earned income’ with campuses being rebuilt and the number of staff and their salaries doubling throughout the sector. As a result, higher education would now be identified as the UK’s largest service sector and an example of international best practice, with the government boasting that it now ‘invests’ more in higher education than any other country. However, such claims fail to take into account where the £100 billion has come from and the good which has been prevented and the damage which has been caused by making this transfer. As previously argued by Bastiat ‘[o]n what basis do you dare to affirm that this official expenditure is an addition to the national industry? Do you not see that it is only a simple *transfer* of consumption and of labour? A cabinet minister has his table more lavishly set, it is true; but a farmer has his field less well drained, and this is just as true’[16].

It is also important to note that even if experts could provide the necessary evidence to prove that more wealth will be created by transferring the £400 from an income taxpayer to

[14] If the government spends £14.3 billion on higher education then it must first take £14.3 billion from the taxpayer, plus the additional amount it costs to collect and then redistribute these funds. Any additional deadweight costs of taxation would also have to be taken into account.

[15] This is why Bastiat concluded that ‘a presumption of economic benefit is never appropriate for expenditures made by way of taxation’.

[16] Bastiat, Selected Essays in Political Economy, 1848.

the local university, taxpayers would still be justified in questioning why there was this ongoing obsession with wealth creation and economic growth. For example, as noted above, the taxpayer was intending to donate £200 to the NSPCC to help prevent cruelty to children before he was taxed. Therefore, what if the taxpayer believes that preventing cruelty to children is more important than economic growth? Whose needs and interests should now take priority?

As noted above, the so called 'cast iron case' for government subsidies is based on the assumption that the subsidy will not only benefit the individual student, but the wider community as well. The suggestion is that when students invest in their own university education, they not only benefit themselves but they also benefit the wider public without intending or knowing about it. Likewise, the unsuspecting public do not know that they are benefiting from the students actions and they doesn't expect or demand to receive such benefits. The self interested acts of students therefore produce substantial public benefits, which appears to confirm the happy existence of Adam Smith's invisible hand. However, according to the prevailing consensus this now represents an example of market failure, which poses a serious threat to all future social and economic development. Therefore, because students are driven by self interest, they are now accused of failing to take into account the needs of the wider public. As a result they fail to invest enough in their own higher education and so insufficient public benefits are produced.

However, while the problem appears to lie with selfish students, the prevailing consensus now claims that the cost of solving the problem must fall upon the public, who are now forced to subsidise students. The public are therefore penalised, despite the fact that they have not demanded these benefits and have no idea what they are or that they are even receiving them. In fact, it would appear that neither the people who produce these benefits, nor the people who receive them, know what these benefits are!

Assuming that each income taxpayer in the UK is currently paying approximately £400 a year to help subsidise higher education[17], the prevailing consensus therefore amounts to this. By taking £400 out of each income taxpayers pocket and transferring it to universities and students, the government is now promising to make each income taxpayer and the wider community better off. Taxpayers should therefore be happy to be taxed, because the spending of these taxes will help to contribute to their employment[18].

[17] In the governments 2003 White Paper (The Future of Higher Education) it states that government funding will increase to around £10 billion a year by 2005–06, 'which is equivalent to around £400 a year paid by every income tax payer in England, whether or not they personally gained from a university education'.

[18] Or in Bastiat's more emotive language, those being robbed, should be happy to be robbed because the product of the theft will contribute to their employment.

However, *what is not seen*, is that if the taxpayer had been left to spend his £400 himself, this spending would also have benefitted both the taxpayer and the wider community. For example, prior to being taxed £400, the taxpayer was going to spend £200 on a new suite and donate £200 to the NSPCC to help prevent cruelty to children. Therefore, without government intervention the taxpayer benefits from having a new suite, the local tailor gets paid £200 and the NSPCC gets a donation of £200. However, after government intervention, the taxpayer is now denied the satisfaction of having a new suite and both the local tailor and the NSPCC have each been denied £200 of additional income. Therefore, when a taxpayer pays £400 in taxes and receives nothing in return, then this clearly constitutes a loss. While it is claimed that the taxpayer will benefit indirectly from his so called £400 investment, *what is not seen* is that the taxpayer would still enjoy the indirect benefits of higher education if students funded themselves. The taxpayer could therefore enjoy the public benefits of higher education, whilst also spending £200 on a new suite and donating £200 to the NSPCC. For example, prior to receiving a government subsidy of £400, the local student was going to invest £400 of his own (via student loans) or his parent's money in higher education. The student would therefore graduate from university and so the taxpayer and wider community would still enjoy all of the public benefits which are said to come from university education. However, this time this would not been at the expense of the taxpayer, the tailor and the NSPCC, who still benefit from the taxpayer spending his £400 in the local community. While the student will clearly be £400 better off if the government did intervene, this clearly represents an unnecessary transfer of income from those who have earned it to those who have no right to it.

While some may try and claim that the £400 will benefit the taxpayer and the wider community more if it is spent on higher education than if the taxpayer spent it himself, their ability to provide any evidence to support this claim is clearly restricted. First, it will be impossible to know what each individual income taxpayer was going to spend his £400 on if he was not taxed and also how much each income taxpayer and the local community would have benefited from this spending. Second, it will also be difficult to know exactly what each individual income taxpayer's £400 is going to be spent on in higher education, as each £400 has the potential to be spent on a multitude of different things[19]. The public benefits that come from each different £400 could therefore be radically different. This suggests that if we don't know or we cannot measure the public benefits that are often associated with a £14.3

[19] For example, in 2008 the £400 from 350,000 income taxpayers was spent by universities on complying with the government's regulatory demands. It is therefore difficult to see how this makes a greater contribution to the local community than if the £400 had been spent by the income taxpayer himself. Some income tax payers will also end up contributing £400 to the salaries of economists, whose primary role is to justify to the taxpayer why they should be handing the £400 over in the first place!

billion public subsidy to higher education, then it is clearly impossible to claim that these public benefits are greater or somehow better than the public benefits which would have occurred if the money was left with the income taxpayer and spent in the local community. In short, as the public benefit argument is based only on *what is seen*, it leads to conclusions which are clearly not valid.

Finally, it is important to note that all of the confusion surrounding higher education and its impact on economic growth has only come about because of the government subsidy and the subsequent need for politicians and economists to try and justify it[20]. This confusion itself can therefore be described as yet another hidden cost or unintended consequence of government intervention. For example, when considering the relationship between investment in higher education and economic growth, it is remarkable how quickly these questions become irrelevant when applied to fully private institutions such as Buckingham University or BPP College. For example, if a student invests £10,000 a year (over two years), to gain a qualification from one of these institutions, will this have a positive impact on economic growth? The honest answer has to be - maybe it will or maybe it won't. As this is a private investment which could have been made for a variety of different reasons, the value of the service received will be entirely subjective and decided by each individual student over a period of time. The personal opinions of politicians, civil servants and experts therefore become insignificant and completely irrelevant.

The promise of wealth and abundance for all is also increasingly being used to justify subsidising university based research, which in 2007/8 amounted to £3.4 billion, an increase from £1.3 billion in 1997. According to a 2007 report published by Research Councils UK, the conventional rationale for public funding of R&D relates to market failure arguments which occur because of the 'likelihood that investors in R&D are unable to appropriate all the benefits which society might derive from research outputs'. This is confidently referred to as a 'well established and robust rationale for much of the Research Councils' activities'.[21] Therefore, according to the prevailing consensus, when a business invests in research and development activities, this not only benefits the business concerned but it also benefits other businesses and the wider public. However, despite the fact that the self interested acts of the business produce substantial public benefits, according to the prevailing consensus this now represents an example of market failure, which poses a serious threat to

[20] For Bastiat, it was deplorable that the act of plunder, when aided and abetted by the law, eventually became a learned doctrine with its own professors, whose intellectual faculties were devoted to finding excuses for plunder in its remote and indirect consequences.

[21] Study on the economic impact of the Research Councils, PART I: Summary, October 2007. Research Councils UK, p.24

future social and economic development. Therefore, the business is now accused of failing to invest enough in R&D and so insufficient public benefits are produced. According to the government this problem can only be solved by introducing a tax on all businesses to help fund research to be carried out by university based academics. This is *what is seen*.

However, *what is not seen* is that there are an endless number of reasons why each of the 2.15 million enterprises registered for VAT and/or PAYE in 2009 may or may not choose to invest in R&D, many of which will have nothing to do with the reason outlined above[22]. As the circumstances of each individual organisation will be different and continuously changing, it is clearly impossible to make any generalisations. The above well established and robust rationale also appears to contradict the experience of those companies which continue to invest in R&D, despite the fact that they may be unable to capture all of the wider social benefits[23]. As previously noted by Kealey[24], R&D is commercially profitable 'not because firms expect to capture all of the returns to their effort, but rather because they can appropriate enough of them to make their investments worthwhile'[25]. The fact that companies spend approximately £39 billion a year on employee training[26], also suggests that companies are more than willing to invest in the future, even though there is no guarantee of capturing all of the wider benefits.

It is also difficult to discuss or criticise levels of private investment in R&D without first taking into account the current rates of business taxation which will clearly have some influence on the levels of private investment in R&D. The current rate of corporation tax in the UK is 28% and in 2007 the receipts from this tax alone were approximately £46 billion. While the rate of corporation tax has been declining over the years (from 33% in 1993), the income generated from corporation tax increased rapidly between 1997 and 2007. Therefore, while the government may be happy to boast about its record of increasing the amount of public investment in R&D from £1.3 billion in 1997 to £3.4 billion in 2007/8, *what is not seen* is that during the same period the revenues the government received from corporation tax alone increased from approximately £30 to £45 billion[27].

[22] For example, a business may decide that instead of investing in R&D, they will benefit much more by introducing an above inflation pay increase to help reward and further motivate employees. Or a business may decide to upgrade its IT hardware and software, or the owner of a medium sized business may have decided to invest £100,000 in R&D one day, only to change his mind and purchase a luxury sports car for £100,000 the next.

[23] R&D is a key expenditure in many sectors. UK aerospace, automobiles, pharmaceuticals and software and technology firms invested substantially more in R&D than they earned as profits'.

[24] For a detailed analysis of *what is seen* and *what is not seen* with reference to the public funding of science and R&D see Kealey 's *The Economic Laws of Scientific Research* (1996) and *Sex, Science and Profits* (2008).

[25] *The Economic Laws of Scientific Research* (1996) T. Kealey

[26] CBI HE Task Force – Key Facts 1, September 2008.

[27] Corporation Tax, T11.1, Statistical Office, May 2009

What is also not seen is that according to the CBI, corporation tax is only one of 22 business taxes and so for every £1 of corporation tax paid, companies pay an additional £1 in the various other taxes. This suggests that the total tax burden in 2007 was over £90 billion. While the UK's corporate tax rate used to be a competitive advantage, large reductions in tax rates in competitor economies have started to erode the UK's position, which makes the total tax burden on UK business relatively high. This is confirmed by PricewaterhouseCoopers whose 2008 Total Tax Contribution (TTC) of the UK's largest companies found that the UK had the highest average Total Tax Rate (TTR), apart from the US and Belgium.[28] The CBI report concludes by warning that an uncompetitive tax system will not only erode the competitiveness of businesses, but it also risks driving economic activity abroad. Therefore, unless the increasing tax burden is tackled, the 'competitiveness of UK-based businesses will continue to deteriorate which will significantly damage the UK economy'[29].

Therefore, after taking *what is not seen* into account, the prevailing consensus amounts to this. After removing £90 billion in taxes each year from successful companies across the UK, the government then accuses these same companies of failing to make a sufficient investment in R&D for some other completely unrelated reason[30]. Then, in an attempt to solve the problem of a lack of R&D investment, which they have just created, the government now decides to re-invest a very small percentage of the £90 billion back into R&D. However, the government isn't simply handing the money back to each business so that they can spend it on an existing R&D project, which they have previously been accused of neglecting. Instead, these funds will now be spent on some entirely different and unrelated research which is to be carried out by academic researchers based at publicly funded universities across the UK. Finally, the government then attempts to convince companies that they are doing them a great favour by making this unrelated research available from a local university free of charge.

To add further insult to injury, companies are now accused of failing to make full use of the unrelated research which they have already paid for and which is now freely available from their local university. As noted by Peter Mandelson, one of the biggest challenges lies not with universities, but with businesses 'who simply don't realize the resources they have down the road in the local lab'[31]. This is *what is seen*. However, *what is not seen* is that the process of R&D is difficult enough even when it is carried out internally and directly funded

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[28] Total Tax Contribution - PricewaterhouseCoopers LLP 2008 survey for The Hundred Group.
[29] UK Business Tax: A Compelling Case for Change, CBI, 2008.
[30] Clearly the fact that the government has just removed £90 billion from their bank accounts is going to have at least some impact on how much they can now afford to invest in R&D.
[31] Speech by Peter Mandelson, *Higher Education and Modern Life*, Birkbeck University, 27 July 2009.

and controlled by the company itself. However, when a company doesn't even know that they are subsidising R&D or where this research is being carried out or for what purpose, then the chance of this investment having any positive impact on each of the companies which are funding it must be close to zero. With the benefit of hindsight, the fact that the research councils can highlight a number of isolated examples of where their research grants have helped to develop new products and services or create new companies, is a remarkable achievement in itself.

In a speech in September 2009, the Chancellor, Alistair Darling suggested that despite his government's doubling of the science budget, they still wanted to go further and he concluded that '[t]he private sector couldn't do that alone – it needs to go alongside public investment'[32]. This is *what is seen*. However, *what is also not seen* is that if the £2.8 billion spent by the Research Councils on R&D in 2007 has been funded out of the £90 billion of tax receipts collected from businesses during the same year, then this suggests that there is no such thing as public investment in R&D. Instead all investment is privately financed, with the difference being whether it is carried out by individual companies or by Research Councils and universities. Therefore, while the Chancellor gives the impression that public investment represents a completely separate source of income from any private investment, this is clearly not the case as they both originate from the same source. The illusion is created by simply transferring some of the private funds to the government and then back to the company. Therefore, when the prevailing consensus states that government needs to invest to complement industry funding in order to raise research funding to the socially optimum level, *what is not seen* is that this is simply yet another call for the government to increase the burden of taxation on business thereby restricting businesses ability to invest in R&D even further.

This illusion is also proving sufficient to convince many companies that when they accept public subsidies, this represents a cost free government handout. For example, ESRC claims to be the UK's largest public funder of business research and its Business Engagement Project (BEP) has recently attempted to identify the key management challenges in a number of business sectors. The purpose of the research is 'to assess the demand for academic research to address these challenges'. One sector examined was management consultancy and from research undertaken to date a number of management priorities have been identified including: the professionalization of the industry; the procurement of consultancy services; dealing with risk; the role and management of innovation in consultancy relationships; consideration of alternative business models and

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[32]Alistair Darling Speech on Tuesday 8th September 2009.

finally human resource issues. The project reported that they had found a number of areas where academic research could make a valuable contribution and that they had shown that 'when directly engaging with practitioners, potential users of research output can make useful and credible suggestions for topics of research'!

While the consultancy companies may have been happy to cooperate with this project in the belief that it was not costing them anything, *what is not seen* is that they are paying for this research, albeit indirectly, via taxation. Successful management consultancy companies are therefore being taxed to help fund university based academics to carry out research, whose sole purpose is to find out if any further academic research is required which will help management consultancy companies improve how they manage their own company, a subject in which management consultancy companies themselves are supposed to excel at!

What is also not seen is that the increasing burden of business taxation is continuously being driven by business leaders and their representatives who continue to plead for further subsidies from what they believe to be the government's own separate source of income. For example, according to Sir John Chisholm (Chairman of QinetiQ and the Medical Research Council), the investment case for research is seldom compelling for individual companies because research is inherently unpredictable and the benefits are integrated across the economy. This is why 'it is a natural public good investment for government'[33]. *This is what is seen*. However, *what is not seen* is that Sir John Chisholm is now suggesting that the solution to QinetiQ's lack of investment in R&D can only be solved by demanding that the government use the tax system to take money from all other businesses, in order to subsidise his! Therefore the question which must be asked is whether Sir John Chisholm would be happy approaching other businesses in his local area, including competitors and all small and medium size companies and demanding that they all make a financial contribution to QinetiQ's R&D budget? If so, how could Sir John Chisholm justify this demand on the doorstep and would his suggestion that research is inherently unpredictable and that the benefits are integrated across the economy, be sufficient? Finally, if Sir John Chisholm was not successful in guaranteeing any voluntary contributions, should these companies now be forced by law to make a contribution? Like it or not, this is the reality of the current system.

Echoing similar developments across the rest of higher education, the Research Councils have also been asked to carry out economic impact studies to help justify their use of public funds. The Research Councils jointly describe impact as the contribution that research makes to society and the economy which embraces all of the different ways in which

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[33] Universities and Industry: A perspective on the 21st century relationship, by Sir John Chisholm, Chairman of the Medical Research Council and QinetiQ Group plc, September 2008. p.4

research-related knowledge and skills benefit individuals, organisations and nations by: fostering global economic performance, and specifically the economic competitiveness of the United Kingdom; increasing the effectiveness of public services and policy, and enhancing quality of life, health and creative output.[34] In short, an action or activity is said to have an economic impact 'when it affects the welfare of consumers, the profits of firms and/or the revenue of government'[35].

However, these definitions are clearly based entirely on *what is seen*, because they are taken from the point at which public funds are spent. Therefore, any benefits associated with public spending on R&D are now identified as an economic benefit. For example, an economic impact study published by Research Councils UK in 2008 concluded that every research council 'makes a significant contribution to wealth creation and quality of life within the UK'.[36] However, *what is not seen* is that this fails to take into account the economic activity which has been prevented from taking place by transferring the £2.8 billion from the taxpayer to the Research Councils in the first place. For it should be self evident that when the Research Councils spend £2.8 billion on research, successful businesses are now forced to spend £2.8 billion less. Again this does not represent an addition, but simply a transfer of income. As it will be impossible to find out if the £2.8 billion will have more of an economic impact if it is spent on R&D than if businesses spent it themselves, then there is no evidence to show that this transfer will provide any economic benefit to the nation as a whole.

In a 2008 report titled *Leading the World: The Economic Impact of UK Arts and Humanities Research,* the Arts and Humanities Research Council (AHRC) concludes that £100 million on arts and humanities research generates an 'enormous economic impact'.[37] This is *what is seen*. However, *what is not seen* is that by transferring £100 million from the taxpayer to the AHRC, the taxpayer now has £100 million less to spend in his local community, which will also have an enormous negative economic impact. Again, the important question to ask is whether the £100 million will have a greater economic impact if it is spent by the AHRC or if was left with the taxpayer to spend in their local community? To help answer this question, listed below are three case studies of research projects which received AHRC funding in 2009:

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[34] Leading the World - The Economic Impact of UK Arts and Humanities Research, 2009, p.5.

[35] Increasing the economic impact of Research Councils Advice to the Director General of Science and Innovation, DTI from the Research Council Economic Impact Group. 14th July 2006 p.12

[36] Excellence with Impact - Progress in implementing the recommendations of the Warry Report on the economic impact of the Research Councils PA Consulting Group/SQW Consulting.

[37] Leading the World: The Economic Impact of UK Arts and Humanities Research, Arts and Humanities Research Council, 2008, p.24.

Mediating Post-Soviet Difference: An Analysis of Russian Television Representations of Inter-Ethnic Cohesion Issues (£426,395);

Transforming Technologies and Buddhist Book Culture: The Introduction of Printing and Digital Text Reproduction in Tibetan Societies (£711, 196);

Favela to the World: a Knowledge Transfer collaboration between People's Palace Projects (QMUL) & the AfroReggae UK Partnership (£369,885).

While these projects may help to promote and encourage the arts and humanities, it is clear that the £1,507,476 spent is not going to have a greater economic impact than if it was spent by the taxpayer in the local community. It is therefore fair to conclude that by transferring £100 million from the taxpayer to the AHRC, this will result in less economic growth and not more. This conclusion is hardly surprising as the original purpose of most of the research funded by AHRC is not to stimulate economic growth but to promote the arts and humanities[38]. While there may be reasons why the government wants to take money from the general taxpayer (including those on low incomes), to help subsidise research into the arts and humanities, it is clearly misleading for any government to try and claim that this transfer of income will help to generate any additional economic growth. Therefore, governments can only restrict and distort economic growth and development if they attempt to tax businesses in order to fund either business related or academic research.

3.2 There is no such thing as free higher education

Higher education in the UK used to be free until the introduction of tuition fees in 2003, which now requires students to make a financial contribution themselves. This is *what is seen*. However, *what is not seen* is that there is no such thing as free higher education and even after the introduction of tuition fees, university courses are still heavily subsidised, which involves the government taking money from the general taxpayer (including those on low incomes) and giving it to students and universities. In short, to help fund higher education the government has ended up taxing the poor to help subsidise the rich get richer.

Bastiat previously warned of the corrupting immorality that seeps into the veins of the political system when politicians put themselves at the service of well organized and influential interest groups. When attending the French National Assembly when subsidies were on the agenda he was appalled to see 'with what shameless rapacity everyone tries to

[38] The fact that an economic impact test is being carried out on AHRC's research, suggests that there is now some confusion surrounding the original purpose of the research. Just as business related research is not expected to directly promote the arts and humanities, it is unclear why research in the arts and humanities is now expected to promote economic growth.

make sure of his share of the plunder'. While many individuals and interest groups were more than happy to plead for government subsidies at the National Assembly, they would blush at the thought of being forced into taking the money from the people themselves. It was clearly much easier to get the government to do their dirty work for them. Therefore, a plea for public subsidies is not a plea for government money, but a request that the government take money from those who have earned it in order to give it to those who now claim they desperately need it. Bastiat therefore defined the state as 'the great fiction through which everybody endeavours to live at the expense of everybody else'[39].

The story of the broken university in the UK starts back in 1889 when several private colleges acting as a well organised and influential interest group, finally persuaded the government to do their dirty work for them by taking £15,000 from taxpayers wallets and transferring it into their bank accounts. Within thirty years, this transfer of income had increased to £1 million and as universities would soon loose sight of where the subsidies were coming from they would have no hesitation in continuously asking for more. Universities would also start to fall into the trap of looking to the government to solve an increasing number of their problems, which would inevitably create a culture of dependency, where the thought of surviving without government subsidies becomes inconceivable.

Whatever the historical reasons for the growth in public subsidies, it is impossible to escape the fact that when public subsidies are spent on higher education, some of the taxes being paid by the general taxpayer (including those on low incomes), are now being used to support students who would have a) been prepared to invest in their own university education themselves; b) come from families who would have been prepared to cover the full cost of their children's university education and c) who will expect to earn much more after graduating than many of those who are now being forced to subsidise them. It is therefore incorrect to identify a student from a low income family who is training to become a doctor as being poor, because in the long run this will clearly not be the case[40].

This perhaps helps to explain why there is very little discussion within the academic community about the inequitable nature of the way in which higher education is funded, or which particular individuals and organisations academics believe should be taxed to help subsidise their salaries, research budgets and institutions. It is clearly a subject that many

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[39] Government, Frederic, Bastiat, 1848.

[40] It is also important to recognise that any discusion concerning students is one which concerns all adults over the age of 18. Therefore, if family background is not taken into account when adults choose to borrow money in order to invest in property, it remains unclear why it should be taken into account when adults choose to borrow money in order to invest in higher education. If property can be shown to provide a greater financial return, then why not subsidise mortgages instead of student loans? With an increasing number of mature students entering higher education it also remains unclear at what age an adult is deemed to be independent of his parents.

would much prefer to ignore. This unfortunate hidden cost of government intervention in higher education has previously been criticised by Professor Nicolas Barr (LSE), who has suggested that those campaigning against tuition fees would do well to recognise the simple fact that 'free' means 'someone else pays'[41] and concludes that 'the evidence is unambiguous: 'free' higher education redistributes from poor to rich'[42]. Professor Andrew Oswald (University of Warwick) has also described the British system as unethical, because of the barely discussed subsidy from the badly off to the rich. He concludes that '[e]very year, poor families contribute hundreds of pounds through their taxes to each undergraduate in Great Britain. That is immoral'[43].

Professor Oswald also refers to the muddled logic of many left wing commentators who continue to believe that taxing the poor to subsidise the rich is somehow egalitarian. This is also not a phenomenon which is unique to the UK as Milton and Rose Friedman in the US have previously admitted that 'those of us who are middle and upper-income classes have conned the poor into subsidizing us on a grand scale - yet we not only have no decent shame, we boast to the treetops of our selflessness and public spiritedness'.[44] A similar sense of selflessness and public spiritedness continues to play a role in the national debate on higher education in the UK. For example, union leaders have promised to name and shame every MP who refuses to sign a pledge to oppose a rise in university fees. This is *what is seen*. However, *what is not seen* is that if an MP signs this pledge then this implies that they not only support the current policy of taxing the poor to subsidise the rich, but that they also want this burden of taxation to be increased even further. It will also imply that the MP believes that even though many students and their families can afford to fund their own university education themselves (often via loans), it is still much better if they continue to live at the expense of everybody else, including those on low incomes. *What is not seen*, the shame clearly lies with those special interest groups who demand to live at the expense of everybody else, but who themselves would blush at the thought of having to approach the

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[41] According to Bastiat 'The truth is, the word "gratuitous" as applied to public services contains the grossest, and, I may add, the most childish of fallacies. I marvel at the public's extreme gullibility in being taken in by this word. People ask us, "Are you against *gratuitous* education? Quite the contrary! I'm for them and I would also be for gratuitous food and gratuitous housing.... if these were possible. But the only thing that is really gratuitous is what does not cost anyone anything. Now, public services cost everybody something; the reason they cost the receiver nothing is that everybody has paid for them in advance'. Bastiat, Economic Harmonies, Chapter 17.

[42] The Great Debate – How should Higher Education be funded? 21st September, 2009, London First, Nicholas Barr, Professor of Public Economics at LSE: Raise the cap on top-up fees!

[43] Andrew Oswald, Professor of Economics, University of Warwick, April 14th 2003 Universities, Quality and the Future, Talk to the British University Finance Directors Group Conference in Durham. 2003.

[44] Milton Friedman and Rose Friedman, *Free to Choose,* 1980, p. 172.

public directly and instead prefer to try and shame politicians into doing their dirty work for them[45].

3.2 Undermining the autonomy and independence of private institutions

In February 2009 the Secretary of State stated that the strength of the current higher education system and a prime reason for its world class status lies in the 'autonomy of the universities and colleges themselves'[46]. In April 2009, Tim Melville-Ross (Chair of HEFCE) also stated that institutional autonomy should remain at the heart of the UK's higher education system and that preserving this autonomy would now be HEFCE's most important role in the future[47]. This is *what is seen*. However, *what is not seen* is that as the level of public subsidies has continued to increase, so has the level and nature of government interference and control, which over time has clearly undermined the independent status of universities in the UK.

If universities in the UK were all public institutions, then this would not be a cause for concern. However, according to the Committee of University Chairs, despite each university being different in origin, size and organisation, they all share the following characteristics of being: legally independent corporate institutions; bodies with charitable status; and accountable through a governing body which carries ultimate responsibility for all aspects of the institution[48]. This basic legal distinction between a public and a private institution is important because it is supposed to protect the autonomy and independence of private institutions by providing legal protection against arbitrary and unwanted government interference. In higher education however it would appear that the distinction between the two and the rules restricting government interference have been broken.

The ongoing confusion over the legal status of universities is perhaps not surprising when the current level of government interference and control is taken into account. While governments may not have previously intervened in higher education to purposely

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[45] For those MP's who are genuinely interested in defending the interests of those who have voted them into power - the hard working taxpayer, then instead of signing the pledge, they should instead send a clear signal to students and their unions that they can no longer depend on the government to do their dirty work for them and if they want to continue to live at the expense of everybody else, then they must now be prepared to appeal to the public directly. However, an important condition must also be attached. If students and their unions believe that it is fair and just that those on low incomes should be forced to subsidise their university education through taxation, then students and their unions should now forced to appeal to these same people directly. And if union leaders believe that they occupy the moral high ground on this issue, then they can look forward to a warm and sympathetic response on the doorstep.

[46] Higher Education Debate, 24/02/09

[47] HEFCE Annual Conference , 2009

[48] Guide for Members of Higher Education Governing Bodies in the UK, Committee of University Chairs, March 2009, p.36.

undermine the autonomy and independence of universities, it is clear that despite many well intended government policies, this has been the unfortunate end result.

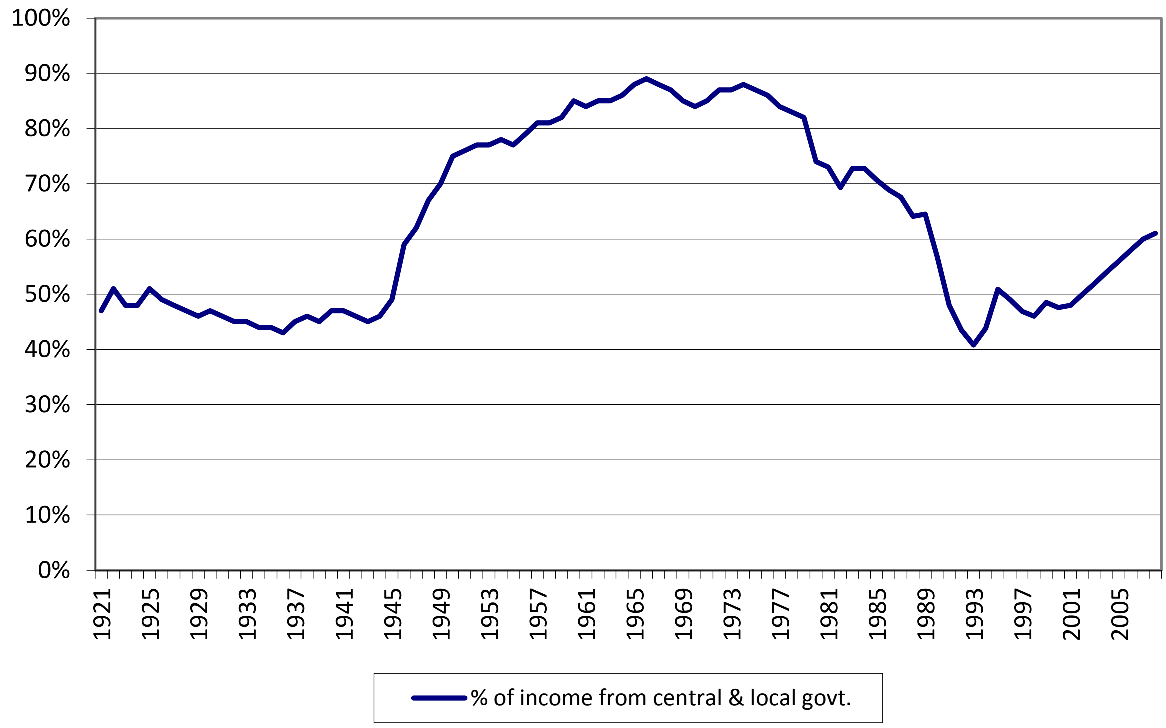
The history of government intervention in higher education shows that even by the late 1920s universities were already dependent for their survival on public subsidies, leaving it difficult if not impossible for politicians to reverse these previous decisions. Therefore, what started as the pleading of several private colleges for minimum financial assistance, it wasn't long before the government assumed responsibility for meeting all universities future financial needs. Post 1945, government intervention also attempted to match the universities future needs with the so called manpower needs of the nation as a whole. Centralised national planning and politics would now begin to dictate the future growth and development of the sector and instead of universities having to appear cap in hand before the government they were now identified as an important national asset. Government intervention was therefore required not only to increase the level of investment in higher education but also to implement the national plan and to address a number of fundamental educational issues which according to Simons (1989) have remained the same and include 'who should be educated, how, to what level or different levels of the service of what social or industrial needs?'[49]

The following graph shows the changing percentage of university income which universities received from government sources throughout the twentieth century.

Graph 1 - Percentage of university income received from government sources between 1910 and 2009[50]

[49] Simon, B. (1989) " The History of Education ", in: Gordon, P.; Szreter, R. (Eds) *History of Education: the Making of a Discipline*, Economica, Paris, 55-72.

[50] *Carpentier, V.,* Historical Statistics on the Funding and Development of the UK University System, 1920-2002 *[computer file]. Colchester, Essex: UK Data Archive [distributor], July 2004. SN: 4971.*



The graph shows that as early as the 1920s, some universities were already receiving more than 50% of their income from government sources, which would become a more permanent feature in the period immediately following World War II. According to the European Community Directives on public procurement, a university is identified as a 'body governed by public law' if it receives more than half of its income from public subsidies[51]. Therefore, according to this definition, those universities in the UK which continue to receive more than 50% of their income from government sources can no longer be described as being autonomous and independent. With the level of income from government sources increasing to over 85% in the 1970s, it would be naive to believe that this level of funding would not have had a significant influence on how universities operate and perform. The graph also shows that since the late 1970s, the percentage of income from central and local government has declined from over 85% to just over 60% today. However, the fact that the level of government interference has moved in the opposite direction during the same period, reinforces a popular criticism of government bureaucracy which is that after a period of time it develops into a permanent feature, making it much more difficult to reverse[52]. This certainly appears to have been the case in higher education, where government regulations,

[51] Guide for Members of Higher Education Governing Bodies in the UK Governance Code of Practice and General Principles, Committee of University Chairman, November 2004, p.24.

[52] A December 2009 report *University Autonomy in Europe* published by the European University Association, suggests that even though national governments and the European Commission recognise the fundamental

quangos and committees are now viewed as permanent and essential features of the UK's higher education sector.

An effective method of controlling the actions of universities has been through the use of conditions or financial penalties attached to each government grant. While it remains unclear what financial penalties different governments in the past would have been prepared to inflict on universities, the *fear* of financial penalties itself has been sufficient to allow the government to extend its powers into almost every area of university life. For example, price capping was sanctioned in Section 23/24 of the 2004 Higher Education Act, which imposed a condition on the governing body of each institution to ensure that its tuition fees did not exceed the specified limit. Any institution which failed to meet this condition is threatened with financial penalties, including the repayment of government grants and the restriction of any future grants. *What is not seen* is that this form of direct government interference is clearly at odds with the independent legal status of universities which are supposed to be accountable through a governing body which carries ultimate responsibility for *all* aspects of the institution. Clearly, if a university is no longer ultimately responsible for determining the price of the services which they provide, then it can no longer be described as being either independent or autonomous.

Another method of controlling the actions of universities has been through the introduction of detailed government regulations relating to almost every aspect of university management. For example, if a university wants to take on a new long term financial commitment, then it must first seek permission from HEFCE, who will only consider such a request when the following information has been provided: a brief description of the new investment and why it is necessary; an explanation of how it broadly fits with the institution's mission and strategic priorities; confirmation that the institution has followed HEFCE guidance on appraising investment decisions; the forms of finance considered and the selection process and criteria; the net present value for each financing option and a brief explanation of why the chosen method was selected; details of the chosen option, including: name of lender, sum borrowed, loan period and basis of repayment; terms and conditions of the financing (for example, a copy of the offer letter) and an evaluation of the risks and uncertainties; an update of the latest financial forecasts, to include the impact of the new investment and financial commitments; details of when the governing body approved the new investment and financial commitments and a minute of the decision reached; and finally a summary of the information the governing body received in reaching its decision. This one example suggests that universities in the UK are now subject to a remarkable level of interference in

importance of university autonomy in the 21st century, governments are still exercising far too much control and they are still either reluctant or unwilling to withdraw.

the day to day management of what are supposed to be private, independent and autonomous institutions. In no other sector of the economy are private institutions subject to such a highly regulated working environment and according to Sir David Watson (Professor of Higher Education Management, Institute of Education) '[t]he amount of political activism and organizational tinkering with higher education that has taken place in the UK is astonishing by both absolute and comparative standards'.[53]

Following his review of the key developments in higher education, Professor Michael Shattock (Institute of Education) concludes that the sector has moved from being 'privately to publicly governed, essentially changing from self governance to governance explicitly by the state'[54]. However, not only are universities now deemed to be governed by the state, but they are also often thought of as being state institutions themselves. The fact that the University of Buckingham has often been referred to as the only private or independent university in the UK, clearly implies that many people have previously believed that every other university was neither private nor independent. The government's 2009 national plan has only added further confusion to the debate by stating that '[a]longside the development of our publicly funded universities and colleges we also see an important role for *fully* private providers over the next 10-15 years' (italics added)[55]. This now implies that all publicly funded private universities are no longer *fully* private. If this is the case, then what are they?

This ongoing state of confusion surrounding the legal status of universities is reflected in the following statement made by Peter Knight back in 2006, when he was the Vice-Chancellor of UCE Birmingham:

> If the policy is that universities are to be private bodies, then stop the micromanagement and treat them as such. As the universities dangle uncomfortably in the void between the public and private sectors, they get the disadvantages of both and the advantages of neither. If only someone could make their mind up which it is to be and stick to it'[56].

Unfortunately for today's Vice Chancellors, even if the current Secretary of State does make up his mind and stick to it, this decision could still be reversed or significantly changed when

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[53] Tinker, tailor, tamper, why? Hannah Fearn, 3rd December, 2009.

[54] The Change from Private to Public Governance of British Higher Education: Its Consequences for Higher Education Policy Making 1980-2006, Michael Shattock, Higher Education Quarterly, Vol 62, No.3, July 2008, p.181

[55] Higher Ambitions - The future of universities in a knowledge economy, Department for Business, Innovation and Skills, 2009.

[56] Peter Knight, So, are universities public or private? Guardian, 20th June 2006.

a different government is next elected into power[57]. All this suggests that there has been a break down in the rule of law in higher education, resulting in arbitrary government which is now free to interfere as and when it pleases. As a result the government is no longer bound by any fixed rules and it remains unclear what the extent and nature of government interference in higher education will be in the future. It is difficult to see how any world class institution can expect to flourish within such a highly regulated, confused and unpredictable working environment.

3.3 Crowding out philanthropic donations

US universities have been much more successful at attracting large endowments than their UK counterparts because the US has always been a strong tradition of private philanthropy in higher education, which has not been the case in the UK. This is *what is seen*. However, *what is not seen* is that there also used to be a very strong tradition of philanthropy in higher education in the UK, as philanthropists played a key role in the founding of hundreds of colleges, institutes and academies across the UK during the eighteenth, nineteenth and early twentieth centuries. This has been confirmed by Professor Eric Thomas (Vice Chancellor of Bristol University) who also admits that 'perhaps we allowed it to slow or even cease in the period after the Second World War, and are only rediscovering it now'[58]. A more accurate interpretation of the events has been provided by Jon Dellandrea, a leading fundraiser in higher education, who suggests that '[e]verything screeched to a halt post-Second World War, maybe earlier, when the welfare state meant that university was free, healthcare was free, taxation was high, and the attitude was 'I gave at the office, thank you very much'[59]. In a recent academic article, Eve Proper (Peabody College of Education, Vanderbilt University) also states that '[g]overnment funding drove out most private giving as support for higher education was transformed into a government responsibility'[60].

Again, while no government policies have been introduced with the specific aim of reducing philanthropy in higher education, it is clear that a number of developments coincided, which had the unintended consequence of restricting and discouraging philanthropic donations throughout the sector. First, before World War I, the government's share of GDP was approximately 10% which increased to 25% by 1919 and to over 45% post World War II. These dramatic increases in taxation over such a short period of time will have had an

[57] For further discussion on the autonomous, independent and private status of UK's universities see 'The English chartered university/college: how 'autonomous', how 'independent', and how 'private'?' by David Palfreyman, Director, Oxford Centre for Higher Education Policy Studies.

[58] University fundraising: Please give generously, The Journal, Eric Thomas, 28 January 2009.

[59] Cash flows when academic passion is shared, says philanthropy tsar, Times Higher Education, 29 May 2008.

[60] Quoted in A gift would mean so much, Hannah Fearn, Times Higher Education, 6 August 2009, p.30.

impact on all philanthropic activity, especially in those sectors which the government was now promising to subsidise[61]. Second, while the government had initially attempted to encourage philanthropic donations by offering matching grants, by the mid 1970s government subsidies were in the form of 'deficiency grants' and so any increase in income from endowments (or tuition fees) would automatically result in a decrease in the government grant. All incentives for universities to increase the level of endowments were therefore removed and universities would become increasingly reluctant to be seen as being well endowed or affluent for fear of loosing government subsidies. As government subsidies were initially introduced to save universities from financial collapse, then there may have been the sense that these subsidies were now dependent on universities remaining financially unsustainable. Third, as universities become increasingly dependent on public subsidies (especially after 1945) their attention would have been increasingly diverted towards securing these funds and to satisfying the attached conditions. Universities would therefore only look to attract philanthropic donations when they failed to attract government subsidies. Therefore the more generous the government is when distributing subsidies, the less need there is for the university to seek philanthropic support. Fourth, as universities gradually became recognized as being heavily subsidised and controlled by governments, they will have become less attractive to some philanthropists.

In previous years, philanthropy has played an important role in helping to finance and stimulate interest in research and development in the UK across all academic fields. For example, the Joseph Rowntree Foundation was established in 1904 to help tackle the root causes of social problems and it continues to spend over £10 million a year on related research. A more recent example can be found in the US, where Sir John Templeton set up the John Templeton Foundation in 1987 with assets of $1.5 billion. The mission of the Foundation is to serve as a philanthropic catalyst for discovery in areas engaging life's biggest questions:

> These questions range from explorations into the laws of nature and the universe to questions on the nature of love, gratitude, forgiveness, and creativity. Our vision is derived from Sir John Templeton's commitment to rigorous scientific research and related scholarship. The Foundation's motto "How little we know, how eager to learn" exemplifies our support for open-minded inquiry and our hope for advancing human progress through breakthrough discoveries[62].

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[61] According to S.J Curtis (History of Education in Great Britain, 1968, p.465) this rapid increase in the levels of taxation also meant that fewer parents could now afford to fund their children through university, resulting in an increasing number of students becoming dependent on government handouts.

[62] John Templeton Foundation website (www.templeton.org/about_us/).

Unfortunately, despite the vast increases in wealth which have occurred in the UK since 1904, there has not been a corresponding increase in the number of private research foundations, addressing issues such as those outlined above. Instead, it is the government and its research councils which are now attempting to dominate the market for both industrial and academic research. Therefore, *what is not seen*, are the numerous research foundations which would have been established, if only the government had not attempted to dominate the sector.

Finally, to suggest that government intervention has crowded out philanthropy in higher education is not to deny that some large scale philanthropy has taken place since 1945, as it clearly has. However, these donations only represent *what is seen*. *What is not seen* are the thousands of philanthropists and alumni who may have considered, or could have been persuaded, to donate money to universities if only the government had not intervened in the manner and to the extent that it has.

3.4. Combining and confusing academic, professional and vocational education

If a university is to gain world class status then it must excel in all areas of higher education, combining academic, professional and vocational studies. This is *what is seen*. However, *what is not seen* is that today's publically funded universities are only attempting to be all things to all men (and women) because of the way in which successive governments have funded universities and because governments have also expected universities to provide access to all of the different subject areas. As a result the concept of specialisation appears to have bypassed the higher education sector altogether and universities have instead moved indiscriminately into all areas of higher education and professional training, many of which could be delivered more efficiently and effectively in the for-profit private sector. Evidence to support this claim comes from the rapid growth in non-subsidised universities in the US and around the world which are now specialising in delivering a variety of professional and business related courses. If this new generation of for-profit institutions can provide the same or better services at no cost to the taxpayer, then this further undermines the need for public subsidies.

Therefore, without government intervention, colleges and universities would have been more likely to specialise and many would have developed into very different institutions[63]. Instead

[63] For example, most of the for-profit higher education institutions in the US focus their activities on delivering educational programmes in career-orientated fields. However, those that are quoted on Wall Street are more likely to concentrate their programmes on computer science, business and health, with over 80 percent offering at least one of these three courses. The 'Wall Street' universities are found to have an even narrower focus than the for-profits in general – offering only 26 specialities compared to 36 programmes in the for-profits in general.

an unintended consequences of government intervention has been the growth of what has previously been defined in the US as the multiversity:

> The multiversity is an inconsistent institution. It is not one community but several. A community. . . . should have common interests; in the multiversity, they are quite varied, even conflicting. A community should have a soul, a single animating principle; the multiversity has several - some of them quite good although there is much debate on which souls really deserve salvation[64].

An important hidden cost associated with this indiscriminate expansion, includes the costs associated with having to design all professional and business related courses so that they conform to the traditional academic model. Not only have these new courses adopted the traditional academic qualification of a degree, but they have also adopted the traditional academic calendar, the traditional academic method of teaching and the traditional academic pay scales. It is also clear that the organisational structure, traditions and culture of a non-profit academic university may not be the most efficient way of working for an institution hoping to deliver world class business related education and research services in the 21st century[65].

Despite the best efforts of universities to excel in both academia and business education and training, there is still some confusion about what the primary role and purpose of each university should be. For example, Sally Hunt (General Secretary of the University and Colleges Union) suggests that universities should be first and foremost 'a learning environment, not a training camp for business'[66] and according to the Prime Minister the purpose of university education is the empowerment and intellectual development of the individual and 'the course and the job a student goes on to, is secondary to that'[67]. If this is the case, then this perhaps helps to explain why so many universities are currently attempting to excel in the delivery of business related courses, but still place very little emphasis on the job a student goes on to. Finally, if universities are not training camps for the world of business, then where are the world class institutions which market themselves as being a training camps for business, where the course and the job a student goes on to are not only their primary concern but their sole concern? This is *what is not seen*.

While many people may have their own personal opinions on what they would like universities to be or to become, the only opinions that should count are those who own,

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[64] Clark Kerr, The Uses of a University, 1963/94, Harvard University Press, p.14.

[65] There also seems to be something odd about a non-profit organisation attempting to deliver courses on the art of profit making. One would assume that it must be possible to generate a profit from teaching others to how to generate a profit.

[66] The class of 2020? 27th November 2008, THES.

[67] Gordon Brown quoted in The class of 2020? 27th November 2008, THES.

control or govern each private autonomous and independent institution. If universities are truly autonomous and independent, then by law, it is these people, and these people alone, who are responsible for deciding the nature and purpose of the institution and how they want it to develop in the future. It is also impossible to ignore the fact that at some point in the near future the current Prime Minister will be replaced by another politician who may well have very different views concerning the future of higher education. This shows how irrelevant and insignificant all politicians' views and opinions are on this matter.

A further hidden cost of universities expanding indiscriminately into the delivery of professional and vocational courses is that those representing the business community in the UK have also developed the habit of expecting politicians to solve an ever increasing number of their problems. For example, on the CBI's website under the heading 'What should government do?' it recommends that they must '[e]nsure there is public funding to support university programs geared to employer needs'[68]. While many businesses may believe that there is no cost from the CBI making such demands on their behalf, *what is not seen* is that there is a significant cost as '[b]usiness contributes a quarter of the taxation income that funds HE through direct business taxes'[69]. Therefore, by making such demands the CBI helps to legitimise the current burden of taxation on business and also encourages the government to increase this burden even further.

Unfortunately*, what is also not seen* is that as far as each university is concerned the income which they receive each year from local businesses, will be recognised as being part of the much larger public subsidy. They will therefore have no idea about how much they receive indirectly from businesses, with many universities unaware that they receive any contributions from the business community. Therefore, because the funds are directed via the government, the link between each business and each university has been broken and so the influence which a customer usually has when paying for a service directly is lost. As a result even if business contributions were doubled overnight, the standard of service they receive in return would not change because it would still be identified as a public subsidy and not a direct payment for a particular service. Individual businesses would also find it difficult to double their contributions overnight, simply because they themselves also have no idea about how much they are currently contributing to higher education via taxation. Therefore, while the CBI demands that there is public funding to support university programs geared to employer needs, what is not seen is that universities will only design and deliver courses to meet employer needs, when employers pay for them directly. *What is also not*

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[68] The CBI/higher education website (http://highereducation.cbi.org.uk/policy/workforce-training/what-should-government-do/).

[69] CBI HE Task Force – Key Facts 1. September 2008.

seen is that when a business makes a contribution to higher education via taxation and receives nothing in return, then this constitutes a loss.

A further unintended consequence of universities expanding indiscriminately into the delivery of professional and vocational courses is that it has encouraged successive governments to engage in the practice of manpower planning. This central planning mentality has flourished under the current government and is reflected in the following statement made by John Denham[70] in March 2009:

> The higher education system needs to play a fuller and more organised role in meeting the national needs for strategic skills. In developing our national competitive strengths we have to ensure that the labour market has the right people with the right skills at the right time.

When adopting this mindset politicians easily fall into the trap of treating students like some form of raw material which needs to be controlled and carefully managed so that they can then play their full part in meeting so called national needs[71]. John Denham continues:

> At DIUS we have seen for some time that individual learner demand or employer demand alone is not sufficient to shape the education and training system, to deliver the necessary numbers of people with the right qualifications. Their individual influence is too weak to shape the system.[72]

However, what is meant by 'the necessary numbers of people with the right qualifications'? What is this magical 'necessary number' and how is it calculated? And what is meant by the 'right qualifications' and who decides what they should be? And what if these 'national needs' come into conflict with the needs of students? Are the needs of students now to be dismissed? Finally, while Denham attempts to identify the lack of the right people with the right skills in the economy as an example of market failure, *what is not seen* is that as manpower planning has been popular with successive governments in the UK from at least the 1960s onwards, individual learner demand and employer demand have played only a limited role in shaping the education and training system. Therefore, if any shortages exist, then this is a direct result of government interference and a clear example of government failure. However, Denham as makes the opposite conclusion, he now believes that the solution clearly lies in continuously increasing central planning and control. And thus the abyss that yawns before us becomes ever deeper.

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[70] In March 2009 John Denham was Secretary of State for Innovation, Universities and Skills.

[71] It is remarkable how quickly some politicians can forget their *raison d'etre*, which is to serve the needs of the people and not dictate what these needs should be.

[72] John Denham, Secretary of State for Innovation, Universities and Skills, Speech 24th Feb 2009, One Whitehall Place, London.

The final hidden cost associated with this indiscriminate expansion of higher education and the ongoing obsession with manpower planning is that it has allowed and encouraged successive governments to develop an exaggerated sense of their own importance. As previously noted by Professor Alison Wolf (King's College, London) 'it does indeed, beggar belief that any central body can identify the needs and plan the training of a country with over 60 million people'.[73] The fact that politicians and civil servants have managed to convince themselves that they are having a positive impact on the design and delivery of adult education and training services across the UK and that they actually hold the key to this sectors future success is now a serious cause for concern.

3.5 Suppressing, distorting and capping tuition fees

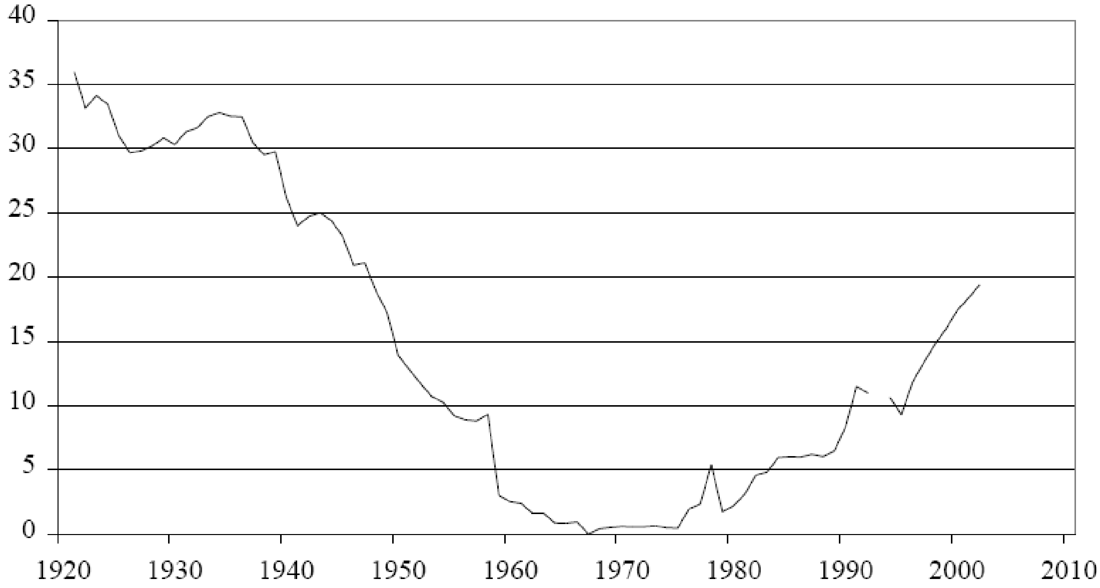
Tuition fees represent an inconvenient barrier in higher education which restricts access to students from low income families. As a result, tuition fees should be capped and if possible abolished altogether. This is *what is seen*. However, *what is not seen* is that tuition fees should be playing the same fundamental role in higher education which prices play in the rest of the economy and any government attempts to distort or control them will have a number of perverse and unintended consequences[74]. Also in a free and open society, if any kind of private institution wants to sell a particular service at a particular price, then they must be free to do so. Simply because some people cannot afford to purchase this service is not a sufficient reason for the government to force the university to cap all tuition fees for both rich and poor alike.

The impact of government interference on tuition fees is reflected in the following graph which tracks the changing percentage share of university income which has been generated by tuition fees from 1920 onwards.

Graph 2 - Tuition fees effectively paid by student as a share of Universities' income (%)

[73] Alison Wolf, Round and Round the Houses: the Leitch Review of Skills Local Economy, Volume 22, Issue 2 May 2007, p.112.

[74] As noted by Sir John Chisholm in his December 2008 report Universities and Industry '[i]n most markets price capping has perverse consequences' (p.8).



Source: Higher Education and the UK Socio-Economic System, Dr Vincent Carpentier, Institute of Education, University of London, Figure 9, p.9.

As the graph shows, the share of university income from tuition fees declined rapidly from the 1920s onwards and between 1955 and 1990 tuition fees accounted for less that 10% of university income. Also, the fact that as early as 1920 tuition fees were only accounting for just over 35% of university income, shows how public subsidies were used from the very beginning to suppress tuition fees[75]. The hidden costs and unintended consequences of subsidising higher education in this particular way have been widespread and substantial.

First, direct government grants and the offer of free or below cost higher education will clearly have helped to increase the demand for higher education[76]. Unfortunately, because each new student now costs the government thousands of pounds each year, and because the government itself has limited access to funds, then it soon becomes unable to expand the supply of universities places in order to meet the increase in demand, which they themselves have created.[77] As a result, two unintended consequences were inevitable -

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[75] In fact this was one of the key arguments used by the private colleges to justify the introduction of government grants, as noted by the following resolution passed at a meeting in Birmingham in 1880:

> That this meeting of the inhabitants of Birmingham is convinced of the national importance of maintaining in great centres of population colleges for advanced education, with such a scale of fees as will place that education within the reach of abler students of all classes (Birmingham Daily Post, Friday, May 27, 1887; Issue 9021).

[76] It is important to note that this demand is best described as artificial. As previously noted by Professor Norman Barry, it is meaningless to talk about the increasing demand for particular university courses when they are being supplied free of charge or below cost price because this tells us very little about their real value.

[77] This problem is not unique to the UK as previously noted by Mark Blaug who has found that '[t]he world provides few examples of countries in which the demand for post compulsory schooling is not constrained by the supply of places that governments decide to make available'. The Methodology of Economics, 1992.

overcrowding and rationing. Overcrowding is perhaps the most obvious and it has been well documented that the average student-staff ratio has increased over recent decades, together with the total number of students attending each individual institution. However, successive governments have also been forced into the widespread rationing of higher education[78].

In 2009 the government announced that English universities would be restricted to admitting only an additional 10,000 students - a figure which had already been reduced from 15,000 due to the onset of financial difficulties. In a letter to the Chairman of the HEFCE in January 2009, the Secretary of State reinforced the need to 'minimise and preferably eliminate over-recruitment' and warned that institutions which over-recruited would face serious financial penalties. As a result it is now estimated that more than 150,000 students will be denied access to university in 2009, representing almost one quarter of those who applied.[79] This represents an extraordinary and an unprecedented level of rationing. Therefore, while the present government may have a goal of sending 50% of all school-leavers to university, it is the government itself which is now the key obstacle to university expansion. Also, if price capping was originally introduced to help improve access to higher education, then this provides a good example of how a well intended government policy, can have the opposite effect of its original intention[80].

Second, while using public subsidies to maintain zero or low tuition fees may have helped to increase enrolments in the short run, it has resulted in less total investment (public and private) in higher education in the long run. For example, it is widely recognised that universities in the US spend up to three times more per student than UK universities, with much of the additional two thirds of investment coming from private sources. This suggests that while the vast majority of students in the UK are forced to accept a fairly homogenous quantity (£10,000) of higher education from government funded institutions, a percentage of students would be willing to invest more than £10,000 if they had the opportunity to do so. Universities are therefore in the current situation in which the government can no longer afford to increase public subsidies, while at the same time they continue to restrict universities from raising extra income by raising tuition fees. This is all despite the fact that

[78] As previously noted by Samuel Britain, '[w]ith zero prices there can be no limit to what is demanded. So some rationing and selection are inevitable'. Financial Times, 07/04/06.

[79] Record enrolments still see 150,000 miss out on a university place, John O'Leary, The Times, October 22nd, 2009.

[80] It is also worth noting that in the UK, students can only apply through UCAS to five different institutions. This system was introduced in the 1960s as the number of students began to increase to try and bring some order to the application process. However, as previously noted by Professor Kedourie it was not obvious that such serious restrictions of choice were necessary and he cites the example of the US where 'students seem to manage without the benefit of such rationing, with neither chaos nor anarchy ensuring' Professor Kedourie (1988), Diamonds into Glass, p.12.

both the government and the universities agree that extra investment in higher education is required and that many students (and their families) would be prepared to pay higher tuition fees, if only the government would allow universities to increase them. Therefore as previously noted by Seldon '[i]f a sizeable part of higher education were financed by students paying fees and by industry placing research contracts and investing in faculties . . . more money would now be going into the universities'[81].

Third, as the share of university income from tuition fees declined from 1889 until the mid 1970s, universities have become less responsive to the changing needs of both students and the business community. This problem was previously highlighted by Adam Smith who complained that at the University of Oxford in the late 18th century many professors had given up even the pretence of teaching. According to Smith, this was because Oxford was already heavily endowed and so the professor's salary was derived from a fund altogether independent of their success and reputation in their particular professions. As the professors no longer depended on the tuition fees paid by each student, there was less of an incentive to cater for and satisfy their changing needs and demands.

Therefore while students may enjoy having other people subsidize their university education, the price they have had to pay is a loss of control over the nature and content of this education and how it is delivered. Based upon Adam Smith's observations, E.G. West has previously concluded that beyond some point, the higher the level of endowment or government subsidy a university receives, the lower its efficiency. Or, the greater the share of the student tuition fees in the total revenues of a university, the greater its efficiency. E.G. West therefore introduced the 'Adam Smith Test' where the threshold of tolerable efficiency is reached when 'the share of student fees in the total operating costs of universities rises to at least 50%'[82]. This test helps to shed light on an important contradiction which lies at the heart of the prevailing consensus, as it suggests that the more public subsidies an institution receives, or the more 'public' an institution becomes, the less responsive it becomes to the changing needs of the public.

Fourth, the percentage of income a university receives from student fees will not only affect how efficient the institution is or how responsive it will be to changing student demands, but it will also have an influence on the ability of other private institutions to compete on a fair and level playing field. Therefore, when a university is made less dependent for its funds on tuition fees, the result has been less competition between a variety of different providers.

[81] Move universities to the market, Arthur Seldon, Economic Affairs, 1980, p.228.
[82] E.G. West, (1999) Reforming the Universities: The Coming Upheaval in Higher Education, Atlantic Institute for Market Studies, p.7.

This point has previously been highlighted by Sir John Daniel (President, Commonwealth of Learning):

> Changing fees policy is important, because what the public sector does in relation to fees clearly constrains the private sector. Having a free public sector alongside an expensive private sector does not create an effective higher education system. As countries gradually introduce fees in the public sector, either because of a conviction that it is more socially equitable or because there is no financial alternative, the private sector finds itself on a more level playing field[83].

Fifth, while attention has focused on how students benefit from not having to pay the full cost of their higher education, much less attention has been directed towards how this influences student behaviour. For example, while subsidized tuition may increase enrolments in the short run, students may then respond to lower tuition levels over time by decreasing their effort levels. If higher education is free or heavily subsidised then less interested students may also be tempted to enrol and they may pay less attention to their choice of university course and therefore be more likely to drop out. The recent reintroduction of tuition fees in the UK and the resulting change in student behaviour, confirms that the amount students have to pay for their own higher education will at least have some influence on their behaviour.

Finally, it was suggested above that tuition fees should be playing the same fundamental role in higher education as prices play in the rest of the economy. In *Common Sense Economics*, this fundamental role is described as follows '[m]arket prices register the choices of millions of consumers, producers and resource suppliers. They reflect information about consumer preferences, costs, and matters relating to timing, location and circumstances that are well beyond the comprehension of any individual or central planning authority[84]. As previously noted by F.A Hayek, in a system where the knowledge of the relevant facts is dispersed among many different people, then a pricing system helps to coordinate their separate actions:

> We must look at the price system as such a mechanism for communicating information if we want to understand its real function . . . The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action.[85]

[83] Does American Higher Education have a Global Future? Sir John Daniel, American Association of State Colleges and Universities, Summer Conference 2007, Vancouver, 26-28 July 2007
[84] 2005 Common Sense Economics, p.24
[85] F.A Hayek, The Use of Knowledge in Society, American Economic Review, XXXV, No.4, September 1945.

Therefore, by transmitting and coordinating this information, the pricing system helps to overcome the widespread ignorance that often prevents the effective utilisation of scarce resources. In short, freely determined prices allow for the greater utilization of knowledge[86]. According to Hayek, this insight will have important consequences once its truth has been accepted because '[e]ither you must confine yourself to creating an institutional framework within which the price system will operate as efficiently as possible, or you are driven to upsetting its function'[87].

Therefore, to understand the real function of tuition fees in higher education it is important to recognise that they should act as an essential mechanism for communicating important information which help universities and students coordinate and direct their resources to where they have the greatest value. Tuition fees should provide universities with information about student needs and demands and how much they are willing to pay. They should also enable students to compare the value of different courses and judge whether they are willing to pay the price asked, or whether their money would be better spent or invested elsewhere. Therefore, *what is not seen* is that tuition fees do not act as a barrier to higher education but provide a critical link between students and universities which helps to coordinate the needs and demands of students, universities and the business community.

As noted above it is clear that public subsidies have been used by universities to suppress the level of tuition fees in order to maintain and increase demand for their services. This suggests that throughout the twentieth century, successive governments have failed to recognise the important role which tuition fees play in higher education. In short, they have excelled in upsetting their function. Therefore, by abolishing and capping tuition fees, the government has completely disrupted the self organising mechanism in higher education, which helps to solve the complex problem of organising which university courses should be provided to help meet the demands of both students and employers. By capping tuition fees the government has also distorted the value of university courses. With many university courses now priced at £3,125, how are students expected to compare and contrast different courses? By denying students this key source of information, it can only lead to confusion, distortion and the waste of their scarce resources. If this kind of intervention had occurred in the market for physical capital, then abolishing all prices or capping prices across a whole sector of the economy would clearly create chaos in the market and restrict its natural growth and development. Therefore, if prices play such an important role in collecting and

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[86] For a more recent discussion on the role of prices in the economy see *The Price of Everything: A Parable of Possibility and Prosperity*, Princeton University Press, Russell Roberts (2008).

[87] F.A Hayek (1986) The Moral Imperative of the Market, chapter in The Unfinished Agenda - Essays on the political economy of government policy in honour of Arthur Seldon, Institute of Economic Affairs, p.145.

communicating information in the market for physical capital, it would be naive to believe that tuition fees will not play a similar role in the market for human capital.

While there is much talk about the importance of knowledge in the new knowledge economy and the important role which universities will be expected to play in collecting and communicating knowledge in the future, there has been much less enthusiasm about recognising the important role which tuition fees should be playing in allowing for the greater utilization of knowledge within the higher education sector itself. It is also difficult to describe any sector of the economy as being world class when it doesn't have a fully functioning pricing system and where politicians are free to dictate the maximum level of prices for all services across the sector, as and when they please. The fact that it currently takes approximately five years, an independent commission, a change in legislation and a large parliamentary majority, before universities can even think about increasing tuition fees, shows just how ridiculous and unworkable the current system has now become.

3.5 Crowding out for-profit institutions and entrepreneurial talent.

In September 2007, BPP College made history by becoming the first for-profit company in the UK to be awarded degree-granting powers by the Privy Council and in July 2009, BPP Holdings Plc was subsequently acquired by the US company Apollo Global, Inc. This is *what is seen*. However, *what is not seen* is that while this was a significant and welcome development, it also suggests that for-profit institutions have been prevented from competing in the UK's higher education sector throughout much of the twentieth century, resulting in one of the UK's most important service sectors now being dominated by a select number of heavily subsidised non-profit charities.

In mid nineteenth century France, Bastiat found that public services will often eliminate private services of the same nature and referred to the example of the shoe industry, which he suggested would fail very quickly if the government decided to give everyone free shoes. For Bastiat it was important to note that the new public service was simply replacing the previously existing private service and therefore tended to add nothing to the nation's wealth. If the public service was then found to be less effective or less efficient than the previous private service, then this transfer of resources would now represent a waste of resources, restricting economic growth and leaving the community as a whole worse off. As noted by the Economist A-Z website '[w]hen the state does something it may discourage, or *crowd* *out*, private-sector attempts to do the same thing. . . . Crowding out may also come from state spending on things that might be provided more efficiently by the private sector.'[88]

While only two decades ago non-subsidised private and for-profit universities were either marginal or absent from the majority of countries, today these new institutions are now capturing a major portion of new enrolments across Eastern and Central Europe, the Middle East, Northern and Sub-Sahara Africa, East and South Asia, and Latin America. According to a 2008 Universities UK report by Professor Roger King, more than one in three students around the world are now studying in the private sector. At a UNESCO World Conference on Higher Education in July 2009, the explosive growth of private higher education was identified as 'one of the most remarkable developments of the past several decades' and according to Philip Altbach, (Director of the Centre for International Higher Education, Boston College) 'private higher education institutions, many of them for-profit . . . represent the fastest-growing sector worldwide'.[89] In some countries private spending on higher education is also now greater than public spending. For example, in Chile, private spending amounts to 1.4% of GDP, with government spending only 0.3%. And in South Korea, private spending is 1.4% of GDP, with government spending only 0.6%[90].

However, these developments lie in stark contrast to those in the UK, where the government has allowed just four new private institutions to enter the UK market since the rules were relaxed in 2004.[91] All of the other major developments have been planned and controlled by central government in accordance with their latest national plan. Critically, as government funded institutions have continued to expand into each new popular area of higher education and training, this has crowded out or prevented from developing, private for-profit institutions attempting to provide similar services. For example, in the government's latest national plan, *Higher Ambitions*, instead of encouraging a variety of world class institutions to invest in the UK higher education sector, the government have stated that they are committed to improving access to higher education, which 'will be achieved, as resources allow, through innovative partnerships between universities and further education colleges, and by support for new local higher education centres under the New University Challenge initiative[92]. The unplanned and spontaneous growth of a for-profit higher education sector appears to taking place in every other country apart from the UK.

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[88] See Economics A-Z at www.economist.com.
[89] 'Remarkable' rise of the for-profit university, Times Higher Education, Phil Baty, 16 July 2009.
[90] Market grows in strength as states run out of cash, Phil Baty, Times Higher Education, 26th November 2009.
[91] These include the ifs School of Finance, the College of Law, BPP and Ashbridge Business School, see Fourth private body wins right to award degrees, Times Higher Educational Supplement, 28th November 2009.
[92] Higher Ambitions, November 2009

The hidden costs and unintended consequences associated with this ongoing obsession with central planning in higher education include the following. First, without for-profit institutions to invest in, private investment in the UK higher education sector has been severely restricted[93]. The recent growth of for-profit universities in the US and around the world suggests that a large number of professional and vocational education and training programs do not need to be delivered by publicly funded institutions.

Second, the crowding out of for-profit institutions and private investment in higher education has resulted in the sector remaining largely a national concern. This lies in stark contrast to other world class sectors of the economy, where a continuous flow of international investment, ideas and innovations, has helped to maintain the sectors world class status. While it may be possible for UK institutions to become world class in the design and delivery of every conceivable higher educational course and programme, it is much more likely that a future world class higher education sector in the UK will include a variety of different institutions from both home and abroad, excelling in a variety of different specialist areas.

Third, as noted above, by crowding out the profit motive in higher education, the UK higher education sector is now dominated by heavily subsidised non-profit institutions which are often assumed to be less likely to take advantage of consumers, especially when they are incapable of evaluating the quality of services provided. *This is what is seen*. However, *what is not seen* is that non-profit institutions are restricted in how they operate in number of ways when compared with their for-profit counterparts[94]. For example, while a for-profit company has an inbuilt incentive to continuously reduce costs and improve efficiency (greater profits will go to universities with the lowest costs of production), a heavily subsidised non-profit institution has less of an incentive because any cost savings may simply translate into a reduction in the government grant. The fact that those working for non-profit institutions may not benefit financially from any cost savings may also reduce the incentive to reduce costs. Publicly funded non-profit institutions may also have less access to private finance to help fund future growth and development and even when the finance is available, there may be less of an incentive for them to expand and multiply. Non-profit institutions are also unable to make use of important financial incentives which could be used to attract entrepreneurs and motivate their staff, such as profit sharing among top management and employee share ownership schemes. Finally, while for-profit companies are subject to a certain amount of external control from the shareholders, there appear to be

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[93] According to the CBI, the UK invests 1.3% of GDP in HE, compared to 2.9% in the US. The difference between the two is largely accounted for by funding from private sources, which accounts for 62% of HE funding in the US, twice as much as in the UK – 31%.

[94] For a useful insight into this issue see Who Profits from nonprofits? Regina E. Herzlinger and William S. Krasker, *Harvard Business Review*, Jan-Feb 1987.

fewer safeguards against mismanagement and inefficiency in non-profit institutions and little effective external control on the boards and committees that run them.

Fourth, if the higher education sector is expected to become a world class service sector, then universities will need to attract some of the UK's best entrepreneurial talent. However, following the crowding out of the profit motive and for-profit institutions, higher education remains one of the least attractive sectors of the UK economy for entrepreneurial talent. For example, many of the incentives used to attract entrepreneurs to work at for-profit companies such as high salaries, bonuses and share ownership are simply not available to non-profit universities. While it is still possible to identify isolated examples of entrepreneurial activity, this still only represents *what is seen. What is not seen* are the thousands of entrepreneurs who would have blazed new trails in higher education if only the government had not intervened and crowded out for profit institutions. They are not seen because they have decided to invest their talent and resources elsewhere.

3.6 Restricting and preventing competition and innovation

The current demands on higher education are often expressed in terms of the need for individuals and organizations to remain competitive in the new knowledge economy. *This is what is seen*. However, *what is not seen* is that this desire to remain competitive also calls for a highly competitive higher education sector, especially with reference to the design and delivery of all non-academic and business related courses. While some may claim that with 169 publicly funded higher education institutions and over 400 private institutions in the UK, sufficient competition already exists, this claim fails to take into account the fact that for any sector of the economy to be described as competitive, then freedom of entry must be guaranteed and a level playing field established. When these factors are taken into account it soon becomes clear that higher education has now become one of the least competitive service sectors in the UK economy.

For example, the most important condition of any competitive market is freedom of entry and as previously noted by Israel M. Kirzner this is 'the legal and institutional prerequisite for the discovery procedure of the market'[95]. However, if an organisation wants to establish a new university in the UK, then they must first gain permission from Her Majesty's Most Honourable Privy Council, a secret body of senior politicians which gives advice to the

[95] Competition, Regulation, and the Market Process: An "Austrian" Perspective by Israel M. Kirzner, Sept 1982 (www.cato.org/pubs/pas/pa018.html).

Queen[96]. Until this permission has been granted it is illegal for any institution to even use the word 'university'. Furthermore, before an organisation can apply to use the word university, it must first have been granted powers by the Privy Council to award taught degrees, which requires an institution to have had no fewer than four years' experience of delivering higher education programmes and it must also conform to an endless number of other regulations to ensure that the new university conforms[97]to the existing model.

Also, by directing public funds to a select number of government approved institutions, instead of to individual students, the government has also created an unfair playing field, as those institutions which receive public funds are now free to offer their services at a much lower price, thereby undercutting the market and crowding out any private non-subsidised competitors. No doubt this method of funding higher education has also forced governments to restrict the number of new universities depending on its financial circumstances at any point in time.

Despite denying access to higher education, the hidden costs and unintended consequences of restricting competition in higher education should be self evident[98]. For example, according to the HM Treasury, vigorous competition is an important driver of productivity performance because it 'strengthens incentives to innovate and ensures that resources are allocated to the most efficient firms'. And as competition encourages firms to reduce prices and improve the quality and choice of goods and services 'it is also the most effective way of ensuring that consumers receive a fair deal'.[99] The Office of Fair Trading 2009 report *Government in Markets* also states that competition drives firms to improve their internal efficiency, reduce costs, adopt new technology, invest in innovation and reduce managerial inefficiency[100]. Critically, the report also refers to the significant benefits which come from the entry or threat of entry of new firms as they will bring with them new ideas and different ways of operating. They will also 'create incentives for existing firms to improve their performance and develop

[96] The Quality Assurance Agency (QAA) offers confidential advice to the Privy Council and it is the QAA's Advisory Committee on Degree Awarding Powers (ACDAP) which is responsible for considering new applications. Membership of this committee must include: three members of the QAA Board; three Vice-Chancellors; one head of a non-university higher education institution; three senior members of higher education institutions and two other persons with experience of sectors of employment that are significant recruiters of graduates. Therefore, the committee deciding who is to gain access to the UK's higher education market is dominated by representatives of the existing providers who clearly have a vested interest in restricting competition.

[97] For a full list of regulations see 'Applications for the grant of taught degree-awarding powers, research degree-awarding powers and university title. Guidance for applicant organisations in England and Wales, Department for Education and Skills', DfES, August 2004.

[98] According to Bastiat '[i]n proportion, then, as private services enter the category of public services, they lose momentum, at least to some degree, and become sterile, not to the detriment of those rendering the services (their pay does not change), but to the detriment of the whole community'. Economic Harmonies, Chapter 17.

[99] http://www.hm-treasury.gov.uk/ent_comp_index.htm

[100] Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, p.6.

their products, in order to avoid loosing market share and being forced to exit the market'.[101] Finally, in *Common Sense Economics,* competition is identified as one of the seven major sources of economic progress because it places pressure on producers to operate efficiently and cater to the preferences of consumers and it gives firms a strong incentive to develop better products and discover lower cost methods of production[102].

In the 2008 White Paper, *Innovation Nation*, it states that '[t]he challenge for policy-makers is to create a framework, at a national and sub-national level, where activities to support innovation are focused on co-operation between the different actors involved'.[103] However, *what is not seen* is that the lack of innovation in higher education has not been caused by a lack of cooperation between the existing universities but a lack competition and a continuous flow of new actors entering the higher education market. Therefore, by restricting competition in higher education, the government has not only restricted the supply of university places, but it has also removed many of the incentives which usually drive improvements in efficiency, a focus on the customer and the process of innovation, leaving all current and future students worse off.

As noted in the 2009 OFT report *Governments in Markets,* government policies sometimes stand in the way of competition and 'prevent innovation from spreading.'[104] A clear example of the lack of innovation spreading across the higher education sector concerns the continuing use of the academic calendar, especially in the delivery of non-academic subjects. As the University of Buckingham and BPP Business College have already shown, it is now possible to deliver an existing three year course in two years by simply redesigning the calendar. This innovation has been discussed for some time, as the following statement in a previous edition of the Economist suggests:

> It might be possible to lengthen the academic year which lasts 24 weeks out of the 52. Oxford works only half time and the result is that four years almost are spent in giving the education of two years. We cannot expect that parents who are not wealthy, and who want a practical education for their sons, will send them to a university from which they are to be absent more than half the year[105].

The fact that this statement appeared in the September 28th 1867 edition of the Economist shows how slow universities have been to respond. While the government has recently recommended that universities introduce 2 year degrees, one wonders how long it will be

[101] Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, p.7.
[102] Common Sense Economics, What Everyone Should Know About Wealth and Prosperity, Gwartney, Stroup & Lee, p.44-48.
[103] Innovation Nation White Paper, DIUS, March 2008, p.77.
[104] Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, p.107.
[105] Economist, September 28th 1867.

before universities begin to take some positive action. The fact that Buckingham and BPP College have already taken the lead raises the question: why are the other universities not also trying to adopt this important innovation, which will increase the efficient use of their resources and provide significant cost savings for students? And, why have Buckingham and BPP College adopted these innovations voluntary, while all other publically funded universities, need to be forced by the government to adopt these same innovations?

Unfortunately, *what is not seen* is that as government intervention now protects universities from an endless stream of new competitors, many of the incentives to innovate or improve no longer exist. With the supply of university places continuously restricted and with universities already at full capacity, universities simply don't need to innovate in order to attract more students. Instead, the government is now forced to introduce its own incentives in order to force universities to improve the services they offer. What occurs spontaneously in an open market quickly turns into a continuous struggle in a closed public sector. As a result higher education shows all of the typical characteristics of a sector which lacks competition and is producer led, with universities offering students any colour as long as it's black. Again, it is students who are now worse off as a result.

The 2009 OFT report *Governments in Markets* concludes that '[f]or the most part, open competitive markets are the best way of maximising consumer welfare and raising economic growth'[106] Compare this however with the following statement made by Richard Brown a former Chief Executive of The Council for Industry and Higher Education (CIHE), who suggests that 'higher education can never be an open market and the CIHE, Government and other informed commentators have always recognised that it is a public as well as a private good serving wider societal and personal development needs'.[107] This comment helps to shed light on another hidden cost associated with government intervention which is that it has resulted in the development of a powerful interest group of 'informed' parties, who represent the existing providers and who are now convinced that publically funded universities are the engines of the new knowledge economy. However, it is pointless to talk about non-profit and academically inclined universities being the engine of a highly competitive, wealth creating, profit driven, free market knowledge economy, when these institutions remain protected from global markets, depend on a £14.3 billion annual government subsidy for their survival and have to put up with an unprecedented level of rules, regulations and political interference. The contrast (or contradiction) between the two could not be greater.

4. CONCLUSIONS

[106] Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, p.6.
[107] Invest for Greatness in Higher Education - Some Funding Ideas, Richard Brown, October 2009.

Levitt & Dubner have previously concluded that conventional wisdom can often be shoddily formed and devilishly difficult to see through. This certainly appears to be the case in higher education where the conventional wisdom is based almost entirely on *what is seen,* whilst conveniently neglecting *what is not seen*. While the academic community have also excelled in making their case devilishly difficult to see through, by placing *what is seen* alongside *what is not seen*, the following conclusion can now be made.

First, there is no evidence to suggest that there will be any economic benefit to the nation as a whole from transferring £14.3 billion each year from taxpayers to students and universities. Second, there is also no evidence to suggest that the public benefits associated with spending £14.3 billion on higher education, will be higher or somehow better than the public benefits associated with the taxpayer spending £14.3 billion in the local community. Third, while many are convinced that the £14.3 billion annual subsidy is helping to create a more equal and just society, it is impossible to escape the fact that part of this annual subsidy represents a transfer of income from those on lower incomes to those who will soon be on higher incomes. In short, the government is taxing the poor to help subsidise the rich get richer.

Furthermore, it is clear that over the years the introduction of government subsidies and the manner in which they have been distributed has resulted in a significant number of hidden costs and unintended consequences which were not part of the governments or universities original intention. These include: undermining the autonomy and independence of private institutions; crowding out philanthropic donations; the complete disruption and distortion of the pricing system; combining and confusing academic, professional and vocational education; the widespread rationing of university places; restricting private investment from home and abroad; crowding out for-profit institutions and entrepreneurial talent, restricting competition and innovation throughout the whole sector and finally qualification inflation.

The one hidden cost which is clearly relevant concerns the widespread rationing of university places. As the whole point of transferring the £14.3 billion from the taxpayer to students and universities in the first place was to encourage *more* higher education and not *less*, it would appear that this intervention is now having the exact opposite effect[108]. In fact, when taking into account all of the other hidden costs and unintended consequences of government subsidies and political interference, it soon becomes clear that they all involve (in one way or another) the distortion and the restriction of the natural growth and development of higher

[108] For example, there are approximately 150,000 students who have been denied access to university this year, with each willing to pay at least £3,000 per annum to gain some form of higher education qualification. It is difficult to believe that such circumstances would exist if higher education in the UK was an open and highly competitive market, as existing and new suppliers would quickly respond to cater for this unmet demand.

education, making it less efficient and less responsive to the needs of students and the business community.

Therefore, not only is the £14.3 billion public subsidy to higher education not providing any economic or public benefit and not only is it transferring income and resources from low income families to those with a higher income, it is now also disrupting, distorting and preventing the natural growth and development of one of the UK's most important service sectors. In short, the £14.3 billion subsidy is now doing much more harm than good. The £14.3 billion annual subsidy to higher education can therefore be compared to the government subsidies which used to support a variety of national champions over the previous half century. Despite all of the good intentions of wanting to create world class industrial sectors in steel, cars, airlines and telecommunications, government subsidies and attempts to centrally plan the development of these sectors, all failed resulting in the exact opposite of this original intention.

It is also important to recognise that government subsidies to these sectors were not removed because the value or importance of these sectors was in decline. On the contrary, it was because the importance of these sectors was continuing to increase that it became imperative to withdraw government subsidies in order to safeguard their future survival and success. Previous experiments with government intervention in other sectors of the economy, therefore suggest that the more important a sector of the economy is then the more important it is that governments do not attempt to subsidise and centrally plan and control these activities and instead restrict themselves to establishing a regulatory framework that will allow and encourage a variety of private institutions to compete and flourish.

Writing in the Guardian in January 2009, Michael Arthur (chair of the Russell Group) and Dr Wendy Piatt (Director General of the Russell Group) warn politicians in the UK that they 'must take a responsible approach to the funding of higher education and recognise that it is one of the jewels in the country's crown, *worthy of protection* because of the extraordinary value that it brings to our society, international competitiveness and economy'[109] (italics added). This is *what is seen*. However, *what is not seen* is that the special pleading of powerful interest groups for protectionism and protectionist policies is now centuries old and based entirely on *what is seen*. For example, the protection of national champions in higher education (or 'jewels in the country's crown') will only restrict competition, discourage innovation and encourage inefficiency, thereby depriving students of lower prices and/or greater choice. As previously noted by Neelie Kroes (European Commissioner for

[109] Universities face meltdown – and all of Britain will suffer, Michael Arthur and Wendy Piatt, The Guardian, Monday 11 January 2010.

Competition Policy) in 2007, protectionist pressures can and must be resisted and '[t]hose who put up barriers, or who don't want to take them down, need to know that they are acting against the interest of their economy and their citizens'[110]. In 2006, the EC Competition Director General was far less charitable when he described national champions as being illegal, immoral and fat![111]

Therefore, the higher people value higher education, the more important it is for the government to restrict all forms of protectionism and instead promote free enterprise and deregulation which will foster innovation, spur competition, increase efficiency and lower prices. These conclusions reinforce those of Psacharopoulos (2004), who suggests that there is now a growing divide across Europe between the protected non-competitive higher education area, and the drive for the internal market and international competitiveness and warns that '[u]nless there is a radical institutional shake-up away from direct state finance and control of universities, academic excellence in the old continent will keep slipping away to more progressive parts of the World'[112].

5. POLICY RECOMMENDATIONS

5.1 A new limited role for government

A world-class higher education sector of the future will not be planned or directed by central government, nor will it be used to achieve any national objectives. Instead, it will consist of a variety of different national and international private, independent, autonomous, for-profit and not for-profit institutions, each with their own specific missions. In a world-class higher education sector of the future, the ends of individual students (and not institutions, politicians or governments) will be supreme and the government will be restricted to establishing a regulatory framework that will encourage a variety of different institutions from around the world to compete and flourish on a fair and level playing field. The purpose of government in higher education will be to guarantee that students have at their disposal the greatest possible number of educational opportunities of all descriptions. Therefore, the most important responsibility of government will be to promote, encourage and stimulate competition throughout the sector. This means creating the conditions which will allow institutions to pursue their own aims and objectives as effectively as possible.

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[110] Speech by Neelie Kroes, European Commissioner for Competition Policy, European competition policy facing a renaissance of protectionism - which strategy for the future? St Gallen International Competition Law Forum, St Gallen, 11th May 2007

[111] Philip Lowe, "What is wrong with National Champions?," Speech to the Enforcing Competition Law Conference, London (June 23, 2006).

[112] George Psacharopoulos, The DICE Report - A Journal of Institutional Comparisons, December 2004.

5.2 Abolish the cap on university tuition fees

A world class higher education sector in the UK will not develop unless all private institutions are free to sell their services at whatever price they choose and the sector as a whole can enjoy the benefits of a fully functioning pricing system. The existing cap on tuition fees must therefore be abolished and legal restrictions should be introduced to prevent any future government from re-introducing such measures which clearly undermine the legal independence of private institutions. Raising the cap would be insufficient for two reasons. First, it would fail to recognise the basic legal right of any private, autonomous and independent institution to control all aspects of their organisation. Second, it would also fail to recognise the extensive hidden costs and unintended consequences of completely distorting and disrupting the pricing system throughout the whole higher education sector. To repeat, a world class higher education sector in the UK will not develop unless all private institutions are free to sell their services at whatever price they choose and the sector as a whole can enjoy the benefits of a fully functioning pricing system.

5.3 Establish full freedom of entry

In the government's latest national plan *High Ambitions*, it states that '[a]longside the development of our publicly funded universities and colleges we also see an important role for fully private providers over the next 10-15 years'[113]. While the report also states that the government has made it possible for such providers to obtain degree awarding powers, this is not sufficient to establish full freedom of entry, which is now critical if a world class higher education sector is to develop in the UK. Whatever the history of the existing regulatory framework involving the QAA and the Privy Council, it is now clearly dated and in need of radical reform. It is therefore recommended that the higher education sector should be treated like any other service sector of the economy, where new competitors are free to enter without first having to seek special permission from a government agency or the Privy Council. The word university[114] is simply a generic term which is used to describe an institution which engages in a variety of education and research activities. In this sense it is no different from similar words such as academy, college or institute and there is no official or agreed definition of what a university is or what a university should strive to become.

[113] Higher Ambitions, Department for Business, Innovation and Skills, p.104

[114] The word university is derived from the Latin *universitas magistrorum et scholarium*, which translates into 'a community of teachers and scholars'.

Therefore, unless a private organisation can claim to have the exclusive right to use and restrict the use of the word 'university', it should not be the role of government to dictate who can and cannot use this word. It is therefore recommended that any institution which wants to use the word 'university' should be free to do so

5.4 Re-directing subsidies from institutions to students

As previously noted by Professor Mark Blaug, there is hardly a country in the world that would not be well advised to radically overhaul the way in which they fund higher education 'so as to make it conform more closely to what are after all rather elementary economic principles of equity and efficiency'[115]. This statement refers to the hidden costs and unintended consequences of public subsidies being directed towards institutions instead of individuals. Therefore, if governments are to continue subsidising higher education, then at the very least they have a responsibility to ensure that taxpayer's money is used in the most effective and efficient manner possible and that it is also used to support those students in genuine need. It is therefore recommended that over time public subsidies should be re-directed from institutions to students, a reform which will help to place students back at the centre of higher education. Funds can be used to subsidise student loans and funds can also be distributed in inverse proportion to family income and they can also be restricted to those students enrolling on courses where a significant financial return is not guaranteed. This reform will also help institutions to regain their autonomy and independence from all forms of central government control and interference, thereby allowing universities to organise and plan their own future growth and development, as and when they please. Finally, the government should also make it clear that direct subsidies are now been phased out across the sector and so new subsidies will not be granted to any new institutions entering the sector. Instead the government should look to offer new entrants a variety of different incentives (see 5.5).

5.5 Extend charitable tax benefits to for-profit institutions

In order to help liberate and stimulate the supply of higher education and increase the number and choice of university places and qualifications available, the government should look to create a level playing field and remove all discrimination between non-profit and for-profit institutions. The current practice of giving tax breaks to non-profit institutions only, clearly discriminates against for profit institutions and creates an unfair playing field. As

[115] The Economic Value of Higher Education, Mark Blaug, Uhlenbeck Lecture, 1990.

previously noted by Malani and Posner (2007), while there may be good arguments for recognizing the nonprofit form and good arguments for providing tax benefits to charitable firms, there are no good arguments for making tax benefits available only to institutions that adopt the nonprofit form[116]. The government's primary focus should *not* be on the type of organisational form an institution chooses to adopt, but on nature of the services which they provide. Therefore, in higher education the law should not link tax benefits to corporate form and so it is recommended that the following tax benefits which are currently offered to charitable nonprofits should now be extended to for-profit institutions operating in the same sector:

- exemption from capital gains tax, and from income tax and corporation tax on income other than trading income arising outside the course of carrying on the primary purpose of the institution;
- ability to recover income tax deducted from deeds of covenant and receipts under gift aid;
- exemption from inheritance tax for donors to institutions;
- substantial relief on business rates.

This reform will also discourage institutions from adopting the non-profit organisational form simply to capture the tax benefits, even though this may be the least effective and efficient method of organising their institution.

5.6 Privatise all business and law schools

In the current economic climate, the most pressing concern is to liberate the supply of all university based professional and business related courses. This will be the only way to guarantee that students receive high quality education and training which is specifically designed to meet the changing needs and demands of the business and wider community. Furthermore, while the services which business and law schools provide have the potential to make a significant contribution to the UK economy, there is no legitimate reason why a future corporate lawyer or a future city banker should expect everybody else, including those on low incomes, to pay for their education and training. This can only increase inequality and injustice and as noted by Bastiat 'what keeps the social order from improving is the constant endeavour of its members to live and prosper at one another's expense'.[117]

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[116] The Case for For-Profit Charities, Anup Malani and Eric A Posner, Working Paper No. 304. University of Chicago, March 2007.

[117] Bastiat, Economic Sophisms, 1845.

While it is clearly impossible to privatise part of an already private institution, it is therefore recommended that all public subsidies to university based business and law schools should be phased out gradually over a period of ten years. During this period these institutions should aim to pass the Adam Smith Test (receive 50% of their income from fees) within five years and then aim to become completely self sustainable within ten. While the specific details of how individual universities and their business and law schools should respond to these changing circumstances is clearly beyond the scope of this report, it is clear that universities will be faced with a number of options including[118]:

- charge full fees and maintain exactly the same organisational model and status;
- charge full fees and adopt the for-profit organisational model and status;
- sell their business and law schools to an international recognised global chain.[119]

A more detailed discussion of possible future options can be found in *Developing future university structures: new funding and legal models*, published by Universities UK in December 2009.

5.7 Encouraging research and development

The only way that the government can encourage business related R&D is to reduce the burden of taxation on each and every business across the UK. A government will not encourage any R&D by taxing successful businesses and then spending these taxes on unrelated research being carried out in universities. This will only restrict and not promote economic growth. It is therefore recommended that all publically funded business related R&D should be phased out over a period of five years. This never has been and never will be the legitimate business of government. That said, Rothbard (1959) has previously outlined a number of initiatives which governments can take to encourage R&D including: tax credits to companies for contributions to universities for scientific research; tax credits to individuals on income tax for contributions to scientific research in universities; making tax deductible, expenses by business in training scientists at universities; making tax deductible, contributions by business to individual scientific research; making educational expenses (for science or other higher education) tax deductible on parents' income taxes and finally a

[118] A more detailed discussion of these future options can be found in *Developing future university structures: new funding and legal models*. Universities UK, 2009.

[119] Having a world class and internationally branded business and law school located on campus is likely to enhance the reputation of some universities much more than if these universities continued in their current attempt to be all things to all men.

decrease in corporation tax to encourage more private investment in research and development[120].

With reference to all non-business related academic research (where the primary objective is not wealth creation), then if a government wants to subsidise it by taking money from the general taxpayer, including those on low incomes, then so be it. However, it should be noted that there is no economic justification for making such a transfer and that a percentage of the public funds spent will simply crowd out private funds already being spent on similar research. A future government would also be justified in removing itself from this debate and instead demanding that those who carry out the research must now approach the public directly, instead of expecting the government to collect funds on their behalf. This would at least appear to be a much more open and democratic method of raising funds and it would also remove any element of force or coercion.

5.8 An Office of Fair Trading (OFT) market study on higher education

To help protect the long term health of the UK's higher education sector, it is recommended that it should now come under the remit of the OFT and that a market study should be carried out immediately[121]. All existing government subsidies and regulations should be examined to see how they impact on the process of competition in higher education and to see if they provide the best possible outcomes for students and the greatest value for money for the taxpayer. Questions asked of each subsidy or regulation should include the following:[122]

Does the subsidy or regulation directly limit the number or range of suppliers? This is likely to be the case if the proposal involves: the award of exclusive rights to supply*;* procurement from a single supplier or restricted group of suppliers*;* the creation of a form of licensing scheme, or a fixed limit (quota) on the number of suppliers.

Does the subsidy or regulation indirectly limit the number or range of suppliers? This is likely to be the case if the proposal significantly raises the costs: of new suppliers relative to existing suppliers*;* of some existing suppliers relative to others, or of entering or exiting an affected market.

Does the subsidy or regulation limit the ability of suppliers to compete? This is likely to be the case if the proposal: controls or substantially influences – the prices(s) a supplier may

[120] See *Science, Technology and Government*, Murray Rothbard, March 1959.

[121] Market studies are carried out under section 5 of the Enterprise Act 2002(EA02) which allows a market-wide consideration of both competition and consumer issues.

[122] Adapted from Government in Markets: Why Competition Matters – A Guide for Policy Makers, OFT, 2009, Box 7.2, p.25

charge – the characteristics of the product(s) supplied, for example by setting minimum quality standards; limits the scope for innovation to introduce new products or supply existing products in new ways.

Does the subsidy or regulation reduce supplier's incentives to compete vigorously? This may be the case where a proposal: exempts suppliers from general competition law; introduces or amends an intellectual property regime; increases the costs to customers of switching between suppliers.

As with all other OFT market studies the possible results could include: enforcement action by the OFT; a reference of the market to the Competition Commission; recommendations to government for changes in the law; recommendations to regulators, self-regulatory bodies and others to consider changes to their rules; encouraging firms to take voluntary action and finally campaigns to promote consumer education and awareness. The OFT should also report on any competition concerns relating to any new draft legislation which are being proposed, including the proposed changes to the cap on tuition fees.