

Choice and Competition in Education Markets

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“People don’t want choice, what they want is a good local school.” These sentiments have been echoed by many of those critical of the Government’s agenda of parental choice and school competition. In response, the Government may contend that parental choice and school competition are a *means* to achieve the end of everyone having a good local school. In the words of American economist Caroline Hoxby, “school choice is a tide that lifts all boats.” This article will analyse to what extent this claim is true.

Choice and competition in markets can be thought of as two sides of the same coin: firms only compete for business when consumers are able to choose where to buy from, and schools only compete for pupils when there is more than one school they could go to.

To understand how competition between schools might lift school quality, it is helpful to begin by studying what competition achieves in standard markets. In short, economic theory tells us that competition is what ensures consumers get a ‘good deal’. Although the objective of firms is to maximise their own profits, competition ensures this is achieved by acting in ways that benefit consumers. Under perfect competition, for example, the threat that informed consumers might go elsewhere forces firms to use inputs efficiently, produce at minimum average cost, and charge a price that only just covers costs. The fact that I can buy a pint of milk from any of a number of local shops forces them all to sell it for about 30p with a smile. In other words, competition between local shops for my custom is a tide that lifts all local shops!

Likewise, under monopolistic competition and oligopoly, firms have to compete in terms of price, quality or both in order to attract consumers, thereby providing us consumers with good value for money. So although the supermarket industry is dominated by a small number of very large players, they still engage in competition in terms of price and quality, so that I can get 2 packs of good quality fresh pasta for £2.50 from either Tesco or Sainsbury’s.

In the absence of competition, however, things are different: in a monopoly environment, the objective of profit maximisation is likely to lead the monopoly to restrict supply so as to charge a high price, giving consumers a poor deal. The fact that Microsoft effectively faces no competition from other sellers of computer operating systems allows them to charge a high price.

But how does this relate to Government-run schools that don’t charge prices and don’t attempt to maximise profits? Advocates of school choice argue that, just like firms, school outcomes can be improved by competitive pressures. Although there is little doubt that teachers want their pupils to succeed regardless of whether there is competition between schools, achieving good exam results requires large amounts of effort (for the teachers as well as the pupils!) Competition means that a set of poor results for a school is likely to reduce the number of children enrolling at that school (because presumably parents want to send their children to the best-performing schools). This may have knock-on effects on funding, and will make it more difficult

for teachers to achieve good results in the future. This provides an added incentive for teachers to put in more effort and get good results in the first place.

To understand whether in practice the school system in the UK creates competitive pressures on teachers, we must understand how it is organised. In theory, parents can choose to send their child to any school in the local education authority. Funding is largely on a per pupil basis, so a fall in enrolment will mean a fall in the amount of money a school has to work with. On this basis, therefore, it seems there may be considerable competitive pressures.

That said, there are reasons to think competitive pressures may in fact be more limited. In particular, local education authorities effectively impose floors and ceilings on the number of pupils a school can admit each year. Places at over-subscribed schools are rationed on the basis of specified criteria, the most important of which is a geographically defined catchment area (note that most schools are not allowed to use academic ability as a criterion). This may lead to school choice operating largely through parents choosing which neighbourhood to live in, and since not everyone can afford to live near a good school, it may in practice be only rich families that have a choice over which school to send their child to. These factors are likely to reduce the extent of competitive pressures.

Do the competitive pressures that exist improve performance? This is a difficult question to answer. The reason is because it is difficult to tell whether apparently higher levels of school competition are actually *causing* higher test scores, or whether they are just *correlated*. It is possible that parents who care more about their children's education choose to live in areas with greater levels of school choice, and these children are likely to do better in school for various reasons.

Economists have come up with various statistical fixes to get round this and other problems. Using these methods, a number of different studies have found no strong evidence to suggest that English schools with more competitors perform any better in terms of exam results. This suggests that school competition has had few beneficial effects, perhaps due to the organisational structures that give schools few financial incentives to compete for students. There is, however, evidence that house prices are significantly higher in areas with schools that have good exam results, suggesting that parents are indeed choosing schools by moving close to them.

Funding of schools works differently in the US, and this creates an additional way in which parental choice and school competition can operate to improve school quality. State schools in the US get their money from a combination of transfers from Government and a tax on properties in local school districts. Pupils are admitted mainly on geographic criteria, so that if you live in a certain school district you can only attend schools in that district. However, you are largely free to attend any school in that district (though sometimes that means you only have a choice of one school). If the school is over-subscribed various other criteria may apply (like if you have siblings at that school or proximity), and these criteria may differ widely across the country – for example, in Chicago lotteries were run to decide which pupils got places!

Since pupils need to live in the district where they want to go to school, property prices tend to be higher in good school districts. But because schools are part-funded by a property tax, schools in good districts get a higher level of funding per pupil (higher house prices equals more tax revenue!) This new funding could mean both new textbooks to improve school quality and a new coffee machine for the staffroom. Moreover, bad schools within school districts will lose pupils to good schools, losing much money and gaining a bad reputation. Therefore, parents' ability to choose in which school district to live forces schools to put in maximum effort to raise school quality, increasing both the number of pupils at that school and funding per pupil ensuring there is filter coffee, rather than instant, in the staffroom! Parents' ability to choose amongst schools within districts forces all schools within that district to maximise effort and school quality so that they don't lose pupils and funding to other schools in the district.

These claims appear to be supported by evidence, but have come under some dispute. There is much evidence that house prices are higher around good schools in the US. Furthermore, a recent paper based on data about schools and house prices in the San Francisco Bay Area has shown that in areas where house prices respond more to good test scores, test scores are higher. Hoxby has also shown that test scores are higher in schools that are potentially subject to greater levels of competition, i.e. those with more schools in the local vicinity, as compared to those that are effectively local monopolies. Moreover, she shows that most of this effect comes through greater school productivity, i.e. greater effort levels amongst teachers! The dispute is over whether or not the statistical fixes needed to work out these results are adequate.

There is, however, a potential problem with school choice. It may be that well-educated, richer parents are better at picking good schools than poorly-educated and poorer parents. If this occurs, then schools may become segregated along lines associated with parental education and household income, with poorer children left in worse schools. However, school choice might actually create *less* segregation than a system of community schooling (where everyone attends the local school). This is because under community schooling, school choice would operate entirely through where parents choose to live, so that children can only go to the best schools if their parents are able to afford to live near them.

Is school choice a tide that lifts all boats? The evidence from the USA suggests that it might be, as it seems to increase school quality across all schools that face reasonable amounts of competition. This is likely to have come through greater levels of effort from teachers. This is what we would have expected, given what economic theory tells us about the role of competition. Evidence from the UK is much patchier, suggesting little effect of competition. This may be because competitive pressures are limited (school numbers and funding vary little from year to year). Therefore, it seems to be the case that school competition can be a tide that lifts all boats, but only if its effects bite financially – not really a surprising conclusion!