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# The Microeconomics of Education and the effect of Government intervention

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## Abstract

Investigates the market models available to central government and how intervention in these markets affects the level of choice parents have in deciding how their children are educated. Reviews the interventions by central government in the past few decades and the effect of devolved regional government on the school market. Finds that the greater amount of choice and competition that has formed part of the rhetoric of governments in the UK in the past few decades can only be achieved if all parents have perfect information. Concludes that if genuine choice is to be realised then central government will have to limit the number of non-homogeneous schools in the market and increase the amount of information available to parents through devolving responsibility for providing education to democratically accountable regional assemblies.

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## Keywords

microeconomics, school market, devolution, central government, regional government, education policy

## Introduction

The school market has been intended to be driven by self-interest, by both parents and education providers. The self-interest of parents, as consumers is in choosing schools that will provide maximum advantage to their children and the self-interest of schools or their senior managers, as producers is in making policy decisions that are based upon ensuring that their institutions thrive, or at least survive in the market (Gewirtz *et al.*, 1995). This paper investigates the market models available to central government and how intervention in these markets affects the level of choice parents have in deciding how their children are educated.

### Perfect Competition Model

The perfect competition model assumes the existence of numerous consumers unable to significantly influence market price as well as numerous small firms unable to significantly influence market supply and who all produce a homogeneous product. Consequently, each firm is a price taker regarding the demand curve for its product as being perfectly elastic at the going market price, perfect information is available in the form of the price of the homogeneous product and there is freedom to enter to leave the market at any time (Griffiths *et al.*, 1996). Governments may want to intervene in perfect competition markets to control the specifications of the homogeneous products being offered to ensure they comply with government objectives or to increase the influence of the consumers or firms in the market. Governments may also want to influence product price either directly or indirectly through introducing tax or incentive schemes, such as vouchers or allowing firms to charge tuition fees.

### Monopolistic Competition Model

The monopolistic competition model assumes the existence of a large number of firms in the market who each act independently of each other, freedom to enter and leave the market at any time, and where each firm produces non-homogeneous products (Griffiths *et al.*, 1996). An example of monopolistic competition in education is a locality where several schools are trying to attract the same student population, and where some schools may want to attract

some parents in preference to others. In these markets, schools can identify these parent niches in the market by specifics or by descriptors. Specifics include such items as the rate at which clients purchase services, the range of products available (e.g. the range of courses or extracurricular activities) and media exposure. Descriptors cover variables such as age, gender, geodemographics (e.g. social structure of a school's catchment area) and people's preferred lifestyle (Harvey *et al.*, 1996).

In a market based on monopolist competition, central government may want to intervene to limit the number of firms, impose regulations relating to the standards and range of products, the customer base and set conditions for entering or leaving the market.

Governments face continued pressure from the electorate and lobby groups to ensure certain consumers have access to educational services, such as individuals from low socio-economic backgrounds or minority groups. This could lead to the imposition of quota systems, where firms are required to accept certain consumers in place of their desired customers to meet government policy.

In markets where firms can enter and exit easily, governments may want to impose restrictions to ensure that consumers continue to receive educational services, even at time when the market would normally require cutbacks or the cessation of certain products. This could materialise in the form of a policy where a school is required to register all students for a particular examination when it is likely the school will drop in the league table as a result.

### **Monopolies and Oligopolies**

A monopoly is a market that is served only by one supplier, known as a monopolist. A monopolist can typically increase its profits by charging a price higher than the competitive equilibrium price and selling less of its product than would be supplied in a competitive market (Bergstrom *et al.*, 2000). Where a monopoly exists in the case of schools, it is most likely to be controlled by the government itself or a firm that the government approves to provide education in a particular locality. Governments may wish to restrict the freedoms of monopolists in these markets through imposing

price restrictions, imposing catchment areas, or through making it possible for more firms to enter the market.

An oligopoly is a market structure in which a few firms dominate the industry. Crucially these few firms recognise their rivalry and interdependence, fully aware that any action on their part is likely to induce counter-actions by their rivals (Griffiths *et al.*, 1996). In these markets, governments may believe that firms are not doing enough to improve standards or attract a greater number of consumers to the market. Governments may wish to intervene through imposing growth targets or imposing penalties if certain standards are not met. This would be done on the premise that it would stimulate competition between firms in the belief that this would increase growth in the sector and improve standards.

### **The Role of Central Government**

Gorad (1998) argues that since central government only intervenes in the home life of a child (i.e. its clothing, shelter, and food) in case of neglect or abuse, it should behave in the same way with education. However, he concludes that effect of markets on schools is not good, suggesting that there are indications that the purportedly damaging effects of the market in schools may be more of a problem in the short-term transition and changeover. Choice experiments in the US found that parents from low socio-economic backgrounds took longer to acquire information on schools, suggesting that current models of school markets fail to offer the perfect information that parents rely on to make an informed decision.

### **The Role of the Market in School Provision**

In the UK, the role of providing education has been provided by Local Education Authorities (LEAs) since the enactment of the Education Act 1902. The 1988 Education Act removed the management responsibilities for schools from LEAs and imposed a role of being responsible for strategic planning. Local authorities were required to devise a formula to determine how it would distribute funds to local schools, which had to be approved by central government.

The Conservative Government further restricted LEAs by making it possible for parents to call a referendum to opt-out of local authority control, which may have been extended to removing education from the remit of local authority responsibility had there not been a change of Government in 1997 (Chandler, 2001). Maynard (1975) argued that in a system of allocating places to schools based on a catchment area, parents have the right to move house, and some can opt-out of the LEA-funded school and send their child to a fee-paying school. Each of these choice strategies requires finance, and so the catchment system provides choice only to those who can afford it. Despite this depiction of choice and competition, it is difficult to describe school markets as free markets (Gerwitz *et al.*, 1995). Through its attempts to control the information system of the education market via national testing, local league tables and other performance indicators, central government asserts a planning function while pursuing the rhetoric of autonomy and choice.

The introduction of the National Curriculum by the Conservative Government in 1988 saw a homogenising of the education being provided across the United Kingdom. This meant that a parent living in the North East of England could move their family to Wales, knowing that their children could resume their education from the same point they were at in their previous school.

The Labour Government that came to power in 1997 decided to continue with the LEA structure and brought the schools that opted-out back into the control of local authorities. This had the effect of removing the market created by the previous administration with a move towards providing education based solely on catchment areas and not the ability to pay or other selection mechanisms. The regional governments that came out of the devolution settlements for Scotland and Wales in 1998 continued this policy by recognising the LEAs as responsible for the funding and direction of individual schools.

Through maintaining the LEA structure, the abolition of league tables and the continuation of the National Curriculum, the regional

governments have adopted a quasi-market approach to perfect competition in which both parents and schools have limited influence in the market and where all consumers have perfect information about a homogeneous product determined by a directly elected government.

#### **Devolution and the School Market**

The devolution settlement left the UK Government responsible for deciding education policy in England and the policies adopted by central government have begun to diverge from the LEA-directed model preferred by the regions.

The UK Governments' plans for a greater number of self-directed and privately-financed schools that are independent of local authorities begins to represent less a perfect model of competition and more a form of monopolistic competition. The market would be inhabited by a large number of providers offering non-homogeneous products, removing the access to complete information and genuine choice from parents.

Despite the 1998 devolution settlement maintaining perfect information within the regions, it has created an alternative marketplace through the different curriculum decided by the regional governments. For example, the National Assembly for Wales has determined different objectives for Welsh schools to that of the UK Government, meaning parents in another part of the United Kingdom that have the information on the Welsh curriculum have the choice of moving to any part of Wales to provide their children with an alternative education irrespective of their socio-economic status.

#### **Discussion**

The current model of regional government in the United Kingdom has created a market with four products on offer, which are accessible depending on the geographical location a consumer chooses to live in. The removal of league tables in some regions has created a situation where the factors determining a parent's choice of schools are not the reputation of an individual school, but the curriculum that is on offer and the quality of life in the area the school is located.

Plans to create regional assemblies in England could lead to further devolution of power relating to education from the Secretary of State, creating a market of twelve products. However, there are no plans by the UK Government to allow the future regional assemblies of England to create a curriculum that reflects regional needs (DTLR, 2002). The UK Government's plans to remove the control of LEAs in providing education could lead to a proliferation of non-homogeneous schools, the loss of perfect information and the magnification of a situation where choice of education is not based on the curriculum provided by a particular region or LEA, but the reputation of an individual school.

The greater amount of choice and competition that has formed part of the rhetoric of governments in the UK in the past few decades can only be achieved if all parents have perfect information. The current emphasis of central government in intervening in the structure of individual schools limits the choice of parents through creating a market with too many providers and too little information. The intervention of the regional governments in Scotland and Wales have demonstrated how parents can be provided with perfect information and the flexibility of being able to move around their region in the knowledge their child will be following the same curriculum. If

genuine choice is to be realised on a United Kingdom level then central government will have to limit the number of non-homogeneous schools in the market and increase the amount of information available to parents through devolving power to democratically accountable regional assemblies.

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