# Education Excellence Idaho

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Policy Briefing


## How Competition Works in K-12 Public Education

By John T. Wenders

*"It's time to admit that public education operates like a planned economy, a bureaucratic system in which everybody's role is spelled out in advance and there are few incentives for innovation and productivity. It's no surprise that our school system doesn't improve: It more resembles the communist economy than our own market economy."*
--American Federation of Teachers President, Albert Shanker.

Many in Idaho are concerned, and puzzled, about the emerging high demand for charter schools. Some are also concerned that private education providers can use charter schools to compete with the traditional public schools, and make a profit to boot. However, these reactions are really measures the widespread public ignorance of how a market economy works and what happens when the government gets involved.

The reason charter schools survive and prosper, despite being funded at only 60-70% of the level of the traditional public schools, and the reason others can enter via the charters and make a profit, is because of shoddy products and cost bloat in the present public school system. To anyone familiar with how markets work, all this is obvious and predictable.

### How Open Markets Work

Here's how an open market economy populated with greedy capitalists who have monopoly power, sell shoddy products, and reap excessive (above normal) profits. There, via the entry of new capacity driven by the profit incentives of other greedy capitalists, the competitive process will, over time, drive inflated revenues (and prices) down to costs.

With revenues driven to costs, including the cost of capital, there are constant pressures to produce at minimum cost, improve products, and to continually search for innovations that will further lower costs and give competitive advantage. Costs will be determined by the value of resources elsewhere in the economy. When customers don't like products, they can vote with their feet. There are always alternatives. Producers are accountable to market forces, operating from the bottom up. Excess profits, low-quality products, inefficiency, and/or bloated costs attract more efficient competitors and their entry will be corrective.

### How Markets Work with Government Involvement

Once government power is injected into a market, either by regulation or government ownership, and with the purest of intentions, the competitive process is turned from serving the consumer, by providing attractive, low-cost, alternatives, to serving the constituencies who benefit from the government regulation and control. Greed doesn't disappear under government control, it is simply directed away from serving the consumer toward serving and enhancing the government power that controls the market.

Instead of monopoly power and excessive profits being attacked and reduced by competitive entry, under government control those who benefit will use the government's power to protect and enhance monopoly power, further increase revenues, and get a share of the inflated revenues. Consumers, faced with a monopoly, can't vote with their feet. Producers are accountable to the top-down political process, not the bottom up competitive one. And the only way this can continue is to enforce artificial barriers to entry that keep others, looking for a piece of the action, from joining the party. These markets become insulated from efficiency-producing entry and competitive discipline.

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These results are exactly the reverse of what happens to excess profits and monopoly power in a market economy: instead of revenues and prices falling to real costs--opportunity costs--expenditures rise and consume available revenues. Innovation and entrepreneurship are directed away from finding ways to reduce expenditures and improve products toward finding ways to manipulate the monopoly regulatory mechanism to protect and increase both revenues and expenditures.

This is a topsy-turvy wonderland of upside-down economics. Alice would be right at home here.

Ironically, the government-sanctioned monopoly power used in this political/economic process would be flatly illegal under the antitrust laws if practiced privately in open markets. And even more ironic, it is the absence of greedy open-market capitalists that produces bloated costs and shoddy products. Greed in an open marketplace produces better results for consumers than greed with government power, even with good intentions.

#### The Classic Example: The US Airline Industry

The classic example was in the pre-1970s US airline industry, when the now-defunct Civil Aeronautics Board exercised monopoly power by setting prices, controlling entry, and regulating the minutia of the services provided. Supply was rationed by allocating operating certificates for city-pair routes. Productivity was low and stagnant. Cost-plus pricing was used to set prices. The unions took advantage of the situation to pump up wages, and accounting "costs" rose to capture the available, inflated revenues. Prevented from competing on price, carriers competed on cost-inflating amenities.

Dozens of lawyers, each with meters running at hundreds of dollars per hour, once argued over the definition of a sandwich. The value of these excess profits and bloated costs was dissipated and capitalized into rents to powerful labor unions, other employees, and the value of operating certificates, all of which appeared on the books of the carriers as "costs", which had nothing to do with real, opportunity, costs.

The subsequent partial deregulation of the airline industry has slowly reversed this process, resulting in lower fares, fewer amenities, wage concessions by unions, layoffs, reduced unit labor costs, and rising productivity, a process that is still going on, much to the chagrin of those who benefited from inflated wages and other "costs" under the regulatory regime.

#### The US and Idaho Public School Industry

The US public school industry operates in exactly the same way. "Costs" have become bloated and rise to meet the revenues made available by the political process. Success is measured by increased "spending", not reduced costs or improved learning. Productivity is low and declining. Product quality has been flat for decades. Technology is frozen by outmoded funding formulas. Competitors are handicapped by classic predatory pricing, and the entry of private schools, home schooling, and, more recently, charter schools, is fought tooth and nail by the entrenched establishment to protect their monopoly profits.

Investment and effort are directed primarily toward manipulating the political/regulatory mechanism to augment and keep revenues flowing, and which are then dissipated mostly into bloated labor costs, exactly like the airline industry. Private, charter, and schools abroad operate at 60-70% of the per pupil costs of US public schools and the former rarely have any administrative superstructure above the school level.

A vast industry of parasites feeds off the regulation-created excess revenues in public education: educrats, state and federal departments of education, colleges of education, education consultants, labor negotiators and mediators, etc., almost all of whom produce nothing as measured by student performance, and who would disappear over-night in an open market environment. The vast numbers of people who benefit from the public education system, either directly or indirectly, provide not only large political largess but also a solid block of voters who will always vote to protect and enhance the revenues flowing to themselves.

Thus, most of what goes on in lower public education has little to do with education. Education matters only as public relations tool aimed at controlling and consoling voters sufficiently into believing that they are getting something for their inflated school taxes.

Little does the public know that beginning with the famous Coleman Report of the early 1960s reams of research has continually shown that over 90% of student achievement is caused by factors beyond school control and spending. It is an industry driven primarily by redistribution, not production. Its operational goal is to extract and protect as much revenue as possible from the public treasury and then redistribute the proceeds to various contending constituencies.

### The Situation in Idaho's Public Schools

To anyone who understands what is going on, the situation in Idaho's public schools, and elsewhere, is not surprising.

Presently, the average total cost of educating a public school student in Idaho is about $8100 per pupil in average daily attendance. If the taxpayers gave the schools $10,000 per student, they would find ways to dissipate the increase. If taxpayers reduced school funding to, say, $5400 per student--about what Idaho's charter schools now get--after much howling and gnashing of teeth the schools would learn to operate more efficiently, just as the airlines are learning.

And guess what? Despite loud claims to the contrary--claims that cannot be supported with a scintilla of evidence--there would be no discernible difference in Idaho's student achievement between these two alternative levels of funding.

### A Final Question and Irony

Now a final economic question for those concerned, puzzled, and startled by what is going on: Doesn't the observation that "for-profit" businesses want to get into Idaho's public education mean that there is parental dissatisfaction and substantial "excess profits" there? Isn't this what the market is telling us? Isn't it telling us that Idaho's state school funding formulas that presume, and freeze, labor intensive methods of production are obsolete?

Of course, under present public school accounting, "excess profits" are not labeled as such--they appear as "costs", like they appeared in the pre-CAB airline industry. Truth in accounting would label them "bloated costs".

And now the final irony. The evidence is that Idaho's education establishment condescended to let Idaho's 1998 charter school bill pass because it thought by funding the charters at only 60-70% of the public schools' the charters couldn't survive and would wither and die. Voila! Accountable only to parents who vote with their feet, they not only survive, but they prosper, have long waiting lists, and others fight to get started. Their very existence contrasts sharply with, and to the detriment of, their monopoly public counterparts. Their presence tells us volumes, not only about themselves, but about the other public schools.

Having failed to hobble the charter schools with underfunding, the establishment now turns to protectionism. This is administered by heavy handed, self-interested, local school boards, such as Meridian's and Nampa's, which now protect the cost bloat in the public schools from classic competitive entry. Even worse, the establishment now threatens a hostile takeover of the charter schools by making their boards subject to the same local election process now controlled by the public school employees and teachers' unions. Recent legislation that allows charter schools to appeal denials of authorization to a state board has local school boards in apoplexy.

Protectionism now sails under the flag of "local control" and the cry for top-down, political "accountability" for the charter schools. However, attracted by shoddy products and bloated costs, the accountability that is gnawing at the public school system is the bottom-up accountability of the marketplace.

The charter schools are delivering that message.