

*The Eighteenth Annual John Bonython Lecture*

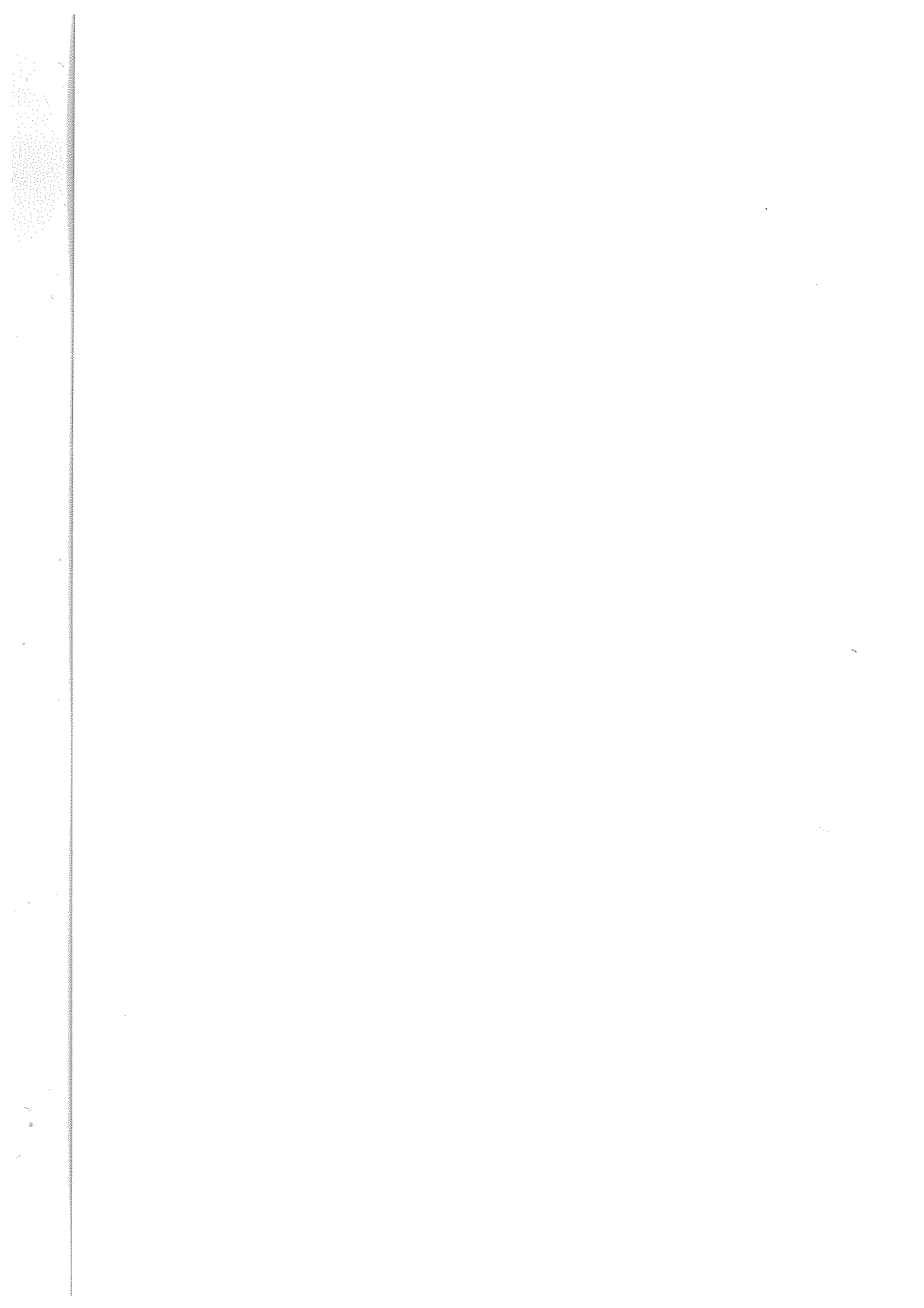
THE CENTRE FOR  
INDEPENDENT  
STUDIES

*what governments  
can't know*

# **What Governments Can't Know**

The Knowledge Economy and the Market

*Lauchlan Chipman*



# **What Governments Can't Know**



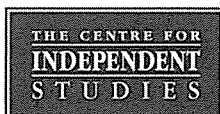
# **WHAT GOVERNMENTS CAN'T KNOW**

THE KNOWLEDGE  
ECONOMY AND THE MARKET

*Lauchlan Chipman*

The Eighteenth Annual John Bonython Lecture  
The Art Gallery of New South Wales  
23rd October 2001

CIS Occasional Paper 77



Published January 2002 by  
The Centre for Independent Studies Limited  
PO Box 92, St Leonards, NSW 1590  
Email: [cis@cis.org.au](mailto:cis@cis.org.au)  
Website: [www.cis.org.au](http://www.cis.org.au)

Views expressed in the publications of The Centre for Independent Studies are those of the authors and do not necessarily reflect the views of the Centre's staff, Advisers, Directors or officers.

National Library of Australia

Cataloguing-in-Publication Data:

Chipman, Lauchlan, 1940-.  
What governments can't know: the knowledge economy and the market.

ISBN 1 86432 063 X.

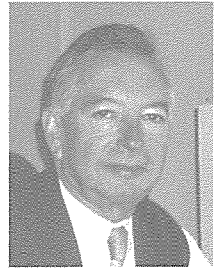
1. Education - Economic aspects - Australia. 2. Education and state - Australia. 3. Research - Economic aspects - Australia. 4. Science and state - Australia. 5. Australia - Economic policy. I. Title. (Series : CIS occasional papers ; 77).

379.94

©2002 The Centre for Independent Studies  
Cover and book design by Heng-Chai Lim  
Edited by Susan Windybank  
Printed by Ligare Pty Ltd, Riverwood, NSW  
Typeset in AGaramond 11pt

## About the Author

**P**rofessor Lauchlan Chipman is Founder and Principal of Lauchlan Chipman and Associates, an independent higher education and management solutions consultancy, immediate past Vice-Chancellor of Central Queensland University, and an Emeritus Professor of the University of Wollongong. He is also a Fellow of the Australian College of Education, and a Fellow of the Australian Institute of Management.







# Opening Remarks

*Professor Steven Schwartz*  
*CIS Academic Advisory Council Member*

Ladies and gentlemen, I would ask you to take your seats now. We are about to come to that part of the evening which is the centrepiece of tonight's celebration and that is the Annual John Bonython Lecture.

Over the years the Bonython Lecture has been delivered by people who represent the most advanced, the most creative, the most thoughtful speakers on areas of liberalism, economics, and politics from all over the world—from the United States, from Europe, from everywhere. Some of those people were Australian residents abroad, but tonight is a first because this actually the first Bonython Lecture which is going to be delivered by an Australian living in Australia—and that is Professor Lauchlan Chipman.

Professor Chipman is of course imminently qualified to give tonight's lecture. This afternoon when I saw him for lunch I asked him whether he wanted the 'Full-Monty' introduction tonight. And he said no, he wanted to get on with it and give us half a chance to hear his speech before you were bored by me giving his whole CV. And it would take that long because his CV is so extensive. So I'm going to just mention a few things.

You would have noticed of course that the invitation to tonight's dinner actually had a letter from Greg Lindsay to Lauchlan Chipman printed on the back. Greg was impressed with Lauchlan, and had written to Lauchlan to ask his help. The first contact that I had with Lauchlan is when I wrote him a letter as well, in response to an article that he had

*Lauchlan Chipman*

written in *The Australian*. Obviously Lauchlan is a person who inspires fan mail! And you can see why that's true. Lauchlan has over the years been associated with prestigious universities—he has worked at Oxford, at Sydney University, at Monash, at Wollongong—and he rose eventually to become Vice-Chancellor of Central Queensland. He has served on a multitude of boards and committees including the Regional Health Board, and the SBS Board. He's been an adviser to many individuals. He's written speeches, articles, books. He's given talks at the most prestigious of all lectures, and he is an Australian College of Education fellow. Most important of all for tonight, he is the first member of the CIS Academic Advisory Council—and of course the longest lasting and probably smartest of us all.

In short, Lauchlan is a distinguished academic, a persuasive thinker, a compelling writer (who elicits fan mail), and the ideal person to be delivering tonight's Bonython Lecture.

So ladies and gentlemen, it's a great pleasure for me to introduce to you tonight's speaker, Professor Lauchlan Chipman.

# What Governments Can't Know

*Professor Lauchlan Chipman*

'Grace is given of God, but knowledge is born in the market.'  
Arthur Hugh Clough, *The Bothie of Tober-na-Vuolich*, Vol. IV, (81).

## **1. The knowledge economy**

The distinguished Massachusetts Institute of Technology (MIT) Lemelson Professor of Economics and Management Lester C. Thurow contends that there have been three monumental industrial revolutions. (Thurow 1999). The first was represented by the enclosures of land. Human society evolved initially from a nomadic hunter-gatherer existence to settled communities, with each community enjoying common access to agricultural and pastoral estates. The next major step was the privatisation of land; this was the revolutionary step that the enclosures laws made possible. The second industrial revolution saw energy replace land as the primary basis of wealth, and had two great phases, the first represented by the invention and mass production of the steam engine; the second phase flowed from the generation and grid-based distribution of electricity. (One is reminded incidentally of Lenin's Report to the Eighth Congress in 1920, in which he defined communism as 'Soviet power plus the electrification of the whole country.' This was about the time that he is supposed to have said that liberty is indeed precious, so precious that it must be rationed!).

The social impact of the second industrial revolution is dramatically summed up by Peter F. Drucker (Drucker 1994) who points out that before the First World War, farmers comprised the largest single group in every country. This is no longer true of any developed country. Despite

the huge shrinkage in the farming population, today Japan is the only free market country which is a net food importer, and that is almost entirely due to its politically motivated unwillingness to embrace free market economics in relation to rice production. In developed free market countries today, including Japan, farmers are at most 5% of the population and workforce.

The third industrial revolution is the one we are living through, in which knowledge—or some would say information—is replacing energy as, in Thurow's phrase, 'the basic building block underlying wealth.' This is the so-called age of the knowledge economy, and one in which the dominant workforce will be, to use the term Drucker claims to have coined in his 1959 book *Landmarks of Tomorrow*, 'knowledge workers'.

Knowledge is importantly different from the other two bases of wealth, land and energy, in that it is the only one of the three that is non-rivalrous in its enjoyment. If I enclose some land for my private use, the total quantum of land available for others is diminished. If I consume a certain number of units of energy from a given source, there is less available to be consumed by everybody else. Neither land nor sources of energy, including solar energy, are infinite in their abundance, or more precisely and relevantly, there is no way in which anybody can appropriate a unit of land or of energy without, at that moment, diminishing to that extent the total that is available for enjoyment by others. By contrast, if I come to know something, that in no way means there is less to be known by anybody else. Indeed, while it is not unique, knowledge is rare among goods in that however much I acquire myself there is still, in John Locke's phrase, 'as much and as good' available to everybody else.

This makes knowledge a very tricky economic resource. For unless it can be privatised, unless something like the enclosures of land can be accomplished with knowledge, there is little economic incentive to produce it. The law of patents, and of copyright, represent our current less than satisfactory attempts to achieve a result in some way comparable with the enclosures laws. The law does it essentially by conferring conditional monopolies on certain classes of originators or innovators, who thus acquire—subject to those conditions—the legal right to be paid rent for the use of their inventions or the reproduction of their

ideas, but only insofar as they have graphically, musically, or textually expressed those ideas.

Patents and copyright pose a now familiar public interest dilemma. The public interest certainly lies in ensuring those who are creative are rewarded for their labours, and can enjoy the fruits of their labours in a way that is somehow commensurate with the downstream value creation they have facilitated. Hence use of their creative products must come at a price—the rent represented by patent or copyright royalties and other fees—and of course any real price is necessarily a barrier to exploitation by others, in that there are very often would-be users who are either unable or unwilling to pay that price.

On the other hand the public interest also lies in ensuring that opportunities for wealth-generating innovation are maximised. This requires us to do two things. The first is to ensure a large pool of people are sufficiently well educated to enable them to comprehend the creative outputs of others; the greater the breadth and depth of the population that is sufficiently well-educated, the greater the prospects for take-up. This is one reason incidentally why an effective knowledge economy requires a level of mass education far more advanced than that required by any previous industrial revolution. (News Limited Chairman Rupert Murdoch and the Business Council of Australia have been absolutely right to stress this in recent days. It is also correctly affirmed in both the Australian Federal Government's Innovation Statement and the Federal Opposition's *Knowledge Nation*. I will return to this theme shortly.) Second, maximising opportunities for wealth-generating innovation also requires us to dismantle those other barriers that stand between creative outputs and those who might draw on those outputs in a potentially wealth-generating innovative way. This includes price barriers. Considered in isolation, the logic of this argument requires that we should therefore get rid of patent and copyright protection.

Thus the paradox. As an incentive to encourage those with talent to exercise the creative powers of their minds we need to protect their enjoyment of the fruits of their creative labours. Hence the need for a law of patents and copyright. But as an incentive to encourage those with the talent to build on the creative labours of others we need to not only strengthen minds through advanced education, but to remove those

barriers that restrict the capacity of subsequent users to exploit in potentially profitable ways the creative outputs of others.

The only practical way of dissolving this paradox is through compromise, and it is fair to say that recent changes to the relevant law in Australia have been by and large sensible moves in that direction. But the tension will always remain. It is not unlike the familiar tension in liberal thought between the right of freedom of expression and the right of the vulnerable to protection. The tension in respect of copyright and patent is compounded by the ease with which creative outputs can be circulated internationally, and the fact that there are inconsistencies internationally not only in the content of municipal laws relating to copyright and patents but the enthusiasm and the rigour with which different jurisdictions are willing to enforce them.

Making laws dealing with copyright and patents is, in my opinion, a legitimate and appropriate task for government. The protection of intellectual property rights in a knowledge economy is comparable in importance to the protection of proprietary interests in land in an agricultural economy. This is probably uncontroversial, but I mention it in the context of a disturbing trend that is becoming manifest in public political discourse, and that is the trend to assume that all one needs to do in order to legitimate a role for government is to demonstrate that the intended end or purpose is a socially useful one. Now while that is a necessary condition for legitimate government involvement, it is hardly a sufficient condition. Indeed, it is fair to say that one of the things that led to the birth of The Centre for Independent Studies a quarter of a century ago was the recognition of how easily, indeed glibly, we can be seduced into inferring from the true premise that a particular end or purpose is socially useful, the conclusion that government should therefore act to bring it about. To adopt an expression of my now octogenarian philosophy tutor at Oxford University, Sir Peter Strawson, 'It is only if one's critical faculties are momentarily numbed by the grossness of the fallacy involved that one could possibly make the inference.'

## **2. Expanding the knowledge base**

In what follows, I would like to consider the implications of the knowledge economy for education, and especially higher education.

To cut to the chase, let me say that I am convinced that there needs to be a massive increase in investment in education, especially higher education, which is the area with which I will be concerned primarily. I am absolutely in agreement with the conclusion that is drawn in the West Committee's Report (a committee on which I had the honour to serve), *Learning for Life*, that within two decades universal or near-universal higher education will be the norm for developed countries. Similar conclusions have been drawn in other reports, and it was also a major conclusion of a UNESCO-sponsored world higher education conference in Paris in 1998. The social utility of this investment in a world of globally competing knowledge economies is I think demonstrable, however I do not intend to provide that demonstration in this lecture. (If you are not persuaded, please just treat it as a working hypothesis in what follows.)

However all too easily, we slip from this realisation, via a fallacy of mind-numbing grossness, to the conclusion that this will require a massive increase in *government* investment. This is a conclusion of which I am simply not persuaded, and it certainly does not follow. Interestingly, at the UNESCO conference to which I referred a moment ago, there was a sobering rider to the recognition that we are on the eve of an age of universal or near universal higher education. This rider was the further recognition that this growth would have to be accomplished without a corresponding increase in the percentage of taxpayer funds devoted to higher education. The key word in my summation is 'corresponding'—most were persuaded, rightly or wrongly, that some increase in taxpayer-sourced expenditure would be necessary, but few appeared to believe that, so far as developed nations were concerned, that the increase would represent a comparable level of taxpayer funds per student as currently prevails.

What then would be the options? One option is to shift a greater portion of the cost burden on to students directly, or to benefactors of students—families, employers, and the like. The assumption that this is the *only* way we can grow the student numbers without growing government investment at the same rate—unless, that is, we are prepared to trade down quality significantly (which of course defeats the purpose)—is one that is all too easily made.

There is another option, and indeed many ways of achieving that option, which is the one I characterised elsewhere as ‘more scholar for the dollar.’ In other words, it is to achieve near-universal higher education for little more than current levels of government investment, essentially through efficiency gains. Essential to the achievement of these efficiency gains, in my opinion, is the substantial involvement of the private sector. I am not talking about the comparatively trivial involvement of having a few hard-nosed business people on university councils, desirable as that may be. I am talking of opening the gates of higher education to for-profit commercially driven universities. There are huge amounts of money to be made in delivering quality higher education, as the early success of some of the small number of new for-profit universities in the United States testifies. The success of universities such as the well-known University of Phoenix has been achieved notwithstanding a regulatory environment and regional accreditation system that is loaded very heavily in favour of the existing not-for-profit and almost always government-subsidised universities.

It is interesting to note that, to the best of my knowledge, no government in the world has privatised education. Yet the arguments for privatising education, be it primary, secondary, or tertiary, are at least as strong as they are for privatising airlines, telecommunications services, energy and water utilities, and hospitals. I won't rehearse those arguments here, except to say that the reason they have not prevailed is the belief that to try to sell that to an electorate in a democracy would be an act of political suicide, while in a non-democracy the government has very good reason for wanting to own and control the education system.

In what follows I am not going to argue for the privatisation of higher education, but rather for the opening up of the higher education sector in Australia to for-profit universities.

### **3. The falling price of the knowledge-intensive**

One of the things that is most striking about our movement into a knowledge economy is what is happening to the prices of the knowledge-intensive. Knowledge-intensive goods such as lasers, mobile phones, electronic equipment, and computer hardware and software have been falling in price while improving in quality for a decade or more. In this



respect knowledge seems to be acting in accordance with a familiar generalisation about commodities. (While it may offend our intellectual sensibilities to say this, knowledge—viewed from a purely economic perspective—does have many of the characteristic features of a commodity, and the term ‘commodity’ is, after all, essentially an economic term.) And while it is with great hesitation that one would venture to call anything a law of economics, the generalisation that *prices of commodities tend to trend downwards* would have to be a candidate, at least when we are dealing with commodities that are renewable and/or substitutable. The process of globalisation can only accelerate this downward trend. However given the wide latitude with which the term ‘globalisation’ is used today, and its very special relevance to the knowledge economy, a word or two about globalisation in general might be in order.

#### **4(a) Globalisation**

The word ‘globalisation’ is now used in an informal, indeed somewhat cavalier way to mean anything that is in some sense international. This is a pity, as it is indeed possible to provide what I believe is a useful and usefully precise definition of globalisation, even if it is to some extent—as all definitions of relatively new and quasi-technical words must be—somewhat stipulative. More precisely what I believe it is possible and useful to define is not so much ‘globalisation’ but a ‘globalised industry’. So, here goes:

An industry is globalised to the extent that:

- (i) it is willing and able to derive its business inputs from wherever in the world it believes it can get best value for money, and;
- (ii) it is willing and able to distribute its business outputs to wherever in the world it believes it can get best money for value.

In consequence, an economy is globalised to the extent that it is dominated by globalised industries, and we live in a globalised world to the extent that we live in a world dominated by globalised economies. Now while it may well be true that we are tending in that direction it is certainly not true, or not yet true, to say that we live in a globalised world, and it is certainly not true, or not yet true, that Australia is a

globalised economy. The extent of movement is not yet sufficient to entail either characterisation, but the movement is certainly in that direction.

It is evident that globalisation and free trade are related, but a word of caution is needed. Restrictions on freedom of trade can include import or export bans, import or export quotas, tariffs, or licences. There are also those which most directly affect labour inputs such as restrictions on immigration or emigration, residency requirements, exclusions, work limitations, union preference, professional accreditation and registration requirements, employment regulation through conditions pertaining to age or qualifications, regulation of minimum wages or salaries, industrial awards, non-salary conditions and other industrial workplace regulations, occupational health and safety regulations, and so on. The word of caution is that other interferences with free trade, such as bounties and subsidies, or more generally the selective allocation of entitlements or privileges, also impact on global input and output movement, although from the point of view of the beneficiary, these are hardly seen as restrictions. Plainly, the longer the list is, the more evident it is that no rational person would regard every trade interference, of whatever nature and degree, as bad, any more than any rational person could regard them all as good. Good or ill, every one of these interferences, in whatever measure, to some extent influences price and/or availability, and to that extent distorts that ephemeral abstraction, the *purely* free market.

It is also evident that, *ceteris paribus*, a globalised industry will tend to gravitate on the input side to those economies in which interferences are fewest, save for those of the entitlement or privilege variety that selectively favour it. But what is it, exactly, that gravitates? The answer can be any combination of investment capital, recurrent expenditure, including labour expenditure, and talent, insofar as imported and/or retained talent is needed to operate and manage the industry in question. On the output side, the goods and services produced will tend to gravitate to those economies into which they can be delivered for the greatest real returns on sales, and these will tend to be economies in which imports of the relevant goods and services are either relatively unimpeded, or alternatively where the impediments selectively privilege the products of the industry or the individual firm in question.

#### **4(b) Globalisation and input disaggregation**

From the productive input side, to the extent that an industry or a firm within an industry has *multiple* inputs to the products or services it provides, to that extent it opens itself to the prospect of globalisation. The most obvious example is the automobile manufacturing (and distribution) industry which has for decades developed the practice of having components manufactured wherever, for whatever reason (for example, proximity to raw materials and/or primary processing plants, local politically delivered subsidies or protection) it can get best value for money, and then assembling those components in whatever territories meet comparable considerations. Factors also taken into account include proximity to export markets, local and international transportation costs, and so on. All major automobile manufacturers take a globalised approach in respect of both business inputs and business outputs.

Automobile manufacture thus provides a classic example of globalisation, however it is hardly an example of free trade; indeed globalisation in the automobile industry has been largely achieved by selective rent seeking. Hence the cautionary word about not exaggerating the relationship between globalisation and free trade. In sum, a free trade environment is neither a necessary nor a sufficient condition for globalisation of a given industry. While aggregate market efficiency enhances globalisation in general, inefficiencies such as subsidies and bounties will commonly influence the global shape of a firm.

#### **5. Higher education and globalisation**

I have argued elsewhere (Chipman 1999) that the higher education industry is one that is going through a process of vertical disintegration. Note that I am talking of the vertical disintegration of the industry, not of every organisation within the industry. By the vertical disintegration of the industry I mean the separation of layers of the industry into specialised producers and providers, each concentrating on one or some only of the layers, allowing others to aggregate these outputs as inputs into particular sorts of aggregate output, such as the credentialing of an individual as a university graduate. If we consider the antecedents of this output, they typically involve research, scholarship, curriculum design, curriculum preparation, pedagogical design, curriculum delivery, access to an attractive reflective environment, assessment, validation,

and documentation. Each of these represents inputs, the ultimate output of which is an individual person credentialed as a university graduate.

There is no inherent reason why each of these inputs must be delivered within the same organisation, and often by the very same people—indeed it is increasingly evident that this is not the most cost-effective way of delivering this particular type of final output.

Note that this is quite a different issue from the question of whether a wholly vertically integrated arrangement provides the ‘best’ overall experience for students, or whether it is the ‘best’ way of ensuring there is immediate linkage between research and teaching. Indeed the desirability of either or both of these ingredients as *essential* to the cost-effective credentialing of a person as a graduate is at best debatable, and in my view plainly false. Rather, the point is that disaggregation is not only possible, it is demonstrably occurring, and is bound to continue to occur, in my opinion at an accelerating rate. It is occurring not so much because of any breaking down of existing higher education institutions, although an increasing number have spin-offs, often run on commercial for-profit principles, which directly provide at best a subset of these inputs. Rather, we are seeing the growth of new organisations, many of them for-profit bodies, which have made a conscientious commercial decision to concentrate on providing perhaps a minority of the inputs themselves, and purchasing the rest—insofar as they judge them necessary at all—either in a commissioned, customised way, or simply ‘off the shelf’. It is this vertical disintegration, aided and abetted by the growing market presence of the for-profit providers that creates unprecedented opportunities for the globalisation of higher education; opportunities that are overwhelmingly in the public interest.

How significant is this growth, and what is its impact? Both questions are difficult to answer. However one of the matters that is perfectly clear is the huge potential for the entry of far greater numbers and/or much larger for-profit providers into the specialist provision of various aspects of the disaggregated layers, including the delivery of the final output, the credentialed graduate. It is interesting to note the performance of the for-profit sector in US higher education, as illustrated in *The Chronicle of Higher Education* for 3 August 2001. This performance is being achieved in a market that, while more liberal

than Australia in the setting of tuition fees, is hardly a free market. On the contrary it is one in which the playing field is very blatantly and deliberately tilted, as it is in Australia, towards public institutions. For-profit higher education providers have to compete not only with huge levels of public subsidies, which in the US extend even to private, albeit not-for-profit providers, but in which accreditation requirements set very high entry barriers, and are administered in ways that are awash with increasingly dubious assumptions about necessary locally available infrastructure—the number of volumes in the library for example—not to mention the inertial pedagogical conservatism that is also common among professional accrediting bodies at large.

This artificial protective environment for existing US universities has meant that those for-profit providers that do make it through regional accreditation requirements (such as the University of Phoenix), and those that are in some way for-profit derivatives of traditional accredited universities, appear to operate with margins as high as 40%, giving them tremendous scope to reduce fees and remain profitable in a genuine price war. On the other hand traditional subsidised universities would not survive without continued subsidies even at present tuition fees, and could not effectively shed costs in a more deregulated market.

## **6. Anomalies in the price of the knowledge-intensive**

There are two glaring anomalies relative to the generalisation that the price of the knowledge-intensive is trending downwards. The two anomalies are the price of access to knowledge-intensive professional services, such as those provided by legal, financial, and medical practitioners, and the price of access to knowledge-intensive qualifications. So far as professional services are concerned, just two points will suffice. The first is that these are areas of commerce in which some of the most significant government-mandated or government-permitted interferences continue to operate, in ways that are not always compellingly justified by public interest considerations. International portability of qualifications continues to be unreasonably limited; professional associations and accrediting bodies set very high entry barriers that are expensive to overcome, in which governments at least acquiesce, while some professions have in effect a quota access, such as medicine in Australia, through the Medicare provider number scheme.

All of these artificially inflate the cost of access to professional services through reduced competitiveness, including price competitiveness. The second point, is that this is exacerbated by the fact that practitioners delivering knowledge-intensive professional services are normally required to have completed at least one advanced knowledge-intensive qualification, and the price of access to knowledge-intensive qualifications, notably university degrees, has itself been increasing throughout this period. Relative to what has been happening in relation to other knowledge-intensive products, what has been happening in relation to the price of access to knowledge-intensive qualifications is a paradox.

## **7. The paradoxical rise in tuition fees**

Why are university tuition fees rising? In the US tuition fees have on balance been rising faster than inflation in most of the years since the mid-1970s. In Australia, if we regard the Higher Education Contribution Scheme (HECS) payment for domestic undergraduates and postgraduate research students as a tuition fee (as it surely is), then it has remained constant in real terms since it was last increased sharply in 1997. However my prediction is that it will rise dramatically once again in 2003 following what will surely be a very tight May 2002 Federal Budget, irrespective of who wins the November 10 2001 Australian Federal election.

The explanation that is usually given for the rise and rise of tuition fees is that cost increases inevitably overtake tuition fees, and increase more rapidly than available endowment, investment income, government grants, or any other forms of potential tuition subsidy. Hence—so the argument runs, and it is a familiar theme in announcements from the Australian Vice-Chancellors Committee (AVCC)—given other sources of accessible revenue are not rising significantly in real terms, or possibly falling, keeping pace is a perpetual trade-off between reductions in the quality of service provision and increases in tuition fees.

Mention the success of not only some of the US for-profit providers, but the for-profit subsidiaries and affiliates of Australian universities, and the conclusion is inevitably drawn that these results could only be achieved by (i) savagely diminishing quality, and/or (ii) short-changing students on core elements of the university experience.

Alas, this response has more of the character of wishful thinking from the established highly subsidised providers, many of whom in Australia appear to have failed to fully exploit the opportunities currently freely available to enrich their institutions despite the regulatory framework within which they operate—a framework which, incidentally, is significantly less restrictive than it was just a decade ago, although the Federal Opposition has perversely promised to re-regulate a significant area of recently gained freedom, by once again banning public universities from admitting Australian undergraduates on a full-fee paying basis. As to (i), to date there is no empirical evidence that what has been called a ‘no frills’ approach to the delivery of higher education causes any diminution whatsoever in terms of the quality of direct academic outcomes, although poor academic outcomes plainly can happen, just as they can and do happen from time to time in relation to particular programmes at particular publicly endowed and protected institutions. I am yet to encounter even one plausible *a priori* argument as to why such a diminution in quality *must* occur. In any case this would fly in the face of the fact that a significant number, I would conjecture the majority in Australia, of the for-profit subsidiaries of public institutions, here and abroad, commonly use identical quality assurance protocols, and for very good reason, regardless of the corporate environment within which the programme or course is delivered.

As to (ii) it is certainly true that for-profit providers commonly do strip out of the input set many elements that contribute to what some people regard as essential components of a university experience. Seldom do they provide manicured lawns on which students can gather and reflect. Rarely do they provide sporting facilities, or give much priority to developing that aspect of personal growth. There are few if any opportunities to mingle socially with research students, or with academic staff who may be actively engaging in a research programme. In fact the environments provided by for-profit providers commonly do not sustain research, and academic staff are rarely engaged with any expectation that they will conduct research, and be paid for doing so. Often academic staff are predominantly part-time, with university level teaching secondary to their primary career. These differences, to the extent that they are real, do mean that a for-profit provider certainly makes available a different set of experiences from those commonly

available in a more traditional public university. But does it matter? For some students, it certainly does. To speak personally, I certainly grew in immeasurable ways from the extracurricular experiences and social environment provided by the University of Melbourne in my undergraduate days. But even then many students, possibly a majority, and certainly most of my peers who matriculated to the University of Melbourne from Essendon High School, did not. They simply took no interest, regarding their university as nothing more than a place where one attended classes, borrowed books, and maybe had a bite to eat if you had an otherwise boring gap between inconveniently scheduled classes.

So the issue in relation to point (ii) is really this: Is it essential if someone genuinely deserves to be credentialed as a university graduate, that they should have undergone experiences of the sort that meant so much to me, and to millions of others throughout the world, as part of this journey? The answer, I submit, is plainly no. If this answer is wrong, then more than half of Australia's university graduates should really be stripped of their credentials, as they took no part in any of this, commonly because they had no desire to, and often because they had no opportunity to do so, as with part-time and distance education students. This is surely a *reductio ad absurdum* of any suggestion that this is essential.

But surely, it will be argued, what is really important is that as many students as possible have the opportunity to have these extracurricular character-forming experiences. There is certainly value in creating opportunities of this sort, but if what is important is the opportunity, then it certainly does not follow that students who have graduated without having had this opportunity are therefore less worthy of their credential.

It is important to recognise that one of the reasons why so much for-profit provision of university education is so very profitable—despite the fact that tuition fees are comparable with or not far below those charged in traditional campus settings—is that students *willingly* pay for the five things they value most. These are all year-round teaching, high quality personal learning resources (notes, videos, and computer software instead of lectures for example), teaching at a location and to a timetable which is personally convenient, small class sizes with high



levels of interactivity, and access to computing and networks with a minimum of queuing. Providing these features, that today's traditional public sector universities now provide very poorly, if at all, and scrapping the manicured lawns, the familiar sporting, cultural, and social amenities, and the traditional academic staffing profile, costs considerably less. This results in the very high margins to which reference has already been made. In essence the fee levels set by public sector institutions have determined the fee regime. For students who perceive the traditional public sector suite of services as constituting an inferior product, the for-profit provider fees are genuinely competitive, high margins notwithstanding.

Why are the cost structures of the existing universities so high? One reason is that in some cases more than half of their salary expenditure goes on administration. Yet despite the sneers of some of academics, many administrators are genuinely overworked. There are two factors lying behind the extraordinarily large share of the salary budget spent on administration. One is lack of scale. There is no reason why one university administration could not, with some supplementation, also administer two or three other universities. Or indeed why the administration of a number of universities could not be outsourced to two or three specialist university management companies. The second is the sheer complexity of each university's own regulatory processes. While many universities have tried and are trying to re-engineer their own academic-administrative processes to eliminate the costs of complexities which add little or zero value to quality or reputation, resistance from the academic community has proved difficult to overcome. On the other hand the for-profit universities have elected to adopt a very simple internal regulatory framework, and have minimised or eliminated academic involvement in their administration, except for the areas of academic quality control. As I understand it, the University of Phoenix for example benchmarks its administration not against that of another university, but against Amex.

The second main reason why the cost structures are so high is the high expectation of research from the academic community. Australian universities exhibit what was introduced to me as a fledgling economics student as 'the wool mutton paradox.' (I believe the example was attributed to John Stuart Mill but I have not located it.) It goes like

this. A farmer notices the price of wool is rising. So he decides to increase his sheep run. But in producing more wool, he is also producing more mutton. In fact the price of mutton is steadily falling. So, depending on their relative price movements, the farmer could actually be worse off for increasing his sheep run.

Now turn your minds from sheep runs to universities. By and large the academic staffing profile is more or less determined by the distribution of students. If the demand for, say, psychology or management increases, the university responds, if it can afford to, by hiring additional academics in psychology and management to meet the increased demand. These academics will of course be expected to conduct research. But by what priority did the university determine that its greatest research needs at that time were in psychology and management? In effect a significant component of each university's research profile is determined by the distribution of its demand for undergraduate courses. Multiply that by 39 universities and you can readily conclude that the national academic research effort not only does not reflect national priorities (however they are determined); it rarely if ever reflects the considered judgement of the universities as to where, ideally, they would like to set their research priorities.

### **8. Running a profitable university**

The for-profit providers do no research beyond that necessary to keep their courses up to date, and often that is specially commissioned from outside experts. As already indicated, by and large the academic staffing is part-time, and there is no expectation that they will make any contribution to research. In terms of the revolution in opportunities for access to higher education these new structures can provide, we are still at the very beginning. The arrival and success of the private for-profit providers explodes the paradox of the rising price of access to knowledge-intensive qualifications. The standard cost of provision throughout the world includes the cost of providing human and physical resources neither necessary, nor commonly desired, for adequate delivery of the qualification to a high quality standard. The successful for-profits provide what their students need and want, and not what traditional providers want them to want.

There is considerable room for economy in not designing and maintaining one's own courseware, but buying it in from other universities, or specialist courseware manufacturers (a little like book publishers) who could, given a sufficient market, draw on the talents of some of the best scholars in the world in designing top line courseware for sale on a competitive basis to those universities that wished to use it. The after-sale service could include keeping the courseware refreshed each year, and providing coaching to the academics who are using it to structure their teaching.

It does not happen now, because there is virtually no market. There is no market because of the dominance of the 'not invented here' syndrome in universities, and the entrenched power of existing academics who would obviously feel threatened by the arrival of excellent materials which can be taught by less qualified people.

There are also significant opportunities for taking advantage of globalisation, particularly in relation to distance and on-line teaching and learning. One of the reasons why the recurrent costs of on-line teaching are comparable with those of face to face on campus teaching is that the academic labour costs associated with real time interactivity are no less than those associated with an on campus tutorial. But they could be lowered significantly. By recruiting on-line tutorial staff from, say, the Philippines or India, one can take advantage of the lower academic labour costs. I doubt however that this is something the Federal Opposition would consider as a reason to support their University of Australia On-line election proposal.

## **9. When is a university...?**

The story is told of a British economist who proposed market driven structural reforms of this type in relation to British higher education. A group of philosophers in the audience was aghast. 'But these things would not be . . . universities', they gasped. 'Very well,' he is reported to have said, 'Then we'll call them something else.'

The trouble with the economist's reply is that unless they are called universities, this will not work. The reason is huge market resistance to obtaining a comparable qualification to a university degree from a comparable institution to a university—what students want is a university degree from a university. They do not care whether it does

research or whether the people who teach them do research. (When I commenced the study of law at the University of Melbourne in 1958, only two academic staff had a higher degree, I doubt that more than a quarter would have been research active, and very many of my class hours, including whole subjects in most years of the course, were delivered by professionals on a part-time basis.)

Students do care that the learning resources are of a demonstrably high standard and that those who are entrusted with managing their learning are well equipped to do so. They do not care whether the learning resources were locally designed and produced or bought in. Why should they? And if they are studying on-line, they do not care in what country their on-line tutor is located, or what he or she is paid—provided their facility in the language of instruction is adequate and their academic and pedagogical competence is evident.

Many of them do not care whether they are studying surrounded by manicured lawns or in leased premises in a suburban shopping complex, provided the facilities are adequate, the class sizes are small, and the location is convenient and sociable. And even if they do like manicured lawns, the evidence is many thousands will readily trade that away for all year round teaching, completing a three-year degree in two, or a four-year degree in three.

But surely these things, whatever name we give them, will concentrate on high demand low cost subjects. There will be plenty of business studies, law, and information technology, but not much in the way of chemistry or classical archaeology. True, but does that matter? Let me not be misunderstood. It is not that I don't think these disciplines matter. On the contrary, I think they thoroughly deserve their place in universities, and that it is a matter for considerable regret that more students do not consider them worth studying. But does it matter that they are not in every university? As it is, most Australian universities offer no classics or classical archaeology, less than half offer philosophy, some offer only one language other than English (if that), some have abolished physics, and chemistry is under threat at others. Already the Federal Government has in effect a tendering system whereby public universities can tender for subsidies to keep certain endangered subjects alive, where it is thought to be in the national interest that these should not become areas of academic extinction in Australia. If that has logic

to it, then there is no reason why a for-profit provider should not be eligible to submit to the tendering process.

But can something really be a university if it neither conducts nor sponsors research? Surely it should be given a different name. Well, in that case, as Professor Alan Gilbert, historian and Vice-Chancellor of the University of Melbourne has pointed out, most things called universities have been misdescribed as such. Historically, most did not conduct any empirical research, and the nearest thing to research they conducted was scholarship, much of which figured in their teaching programmes. Of course this argument is not conclusive, for it is still arguable that given recent history, very few universities do not include research in their missions. The University of Phoenix is one of the few accredited exceptions.

The price of making research essential to something bearing the name 'university' is effectively to lock out a new generation of for-profit providers who will have negligible market appeal unless they call themselves universities. And their reason for being called universities is they are in principle—and in practice as US experience demonstrates—perfectly capable of providing university degrees, the very things that most people link to a university to obtain. They should be subject to, and bound by, independent quality audits of their curriculum, courseware, and delivery, for example, as recently mandated by the Australian Federal Government. That is a reasonable form of consumer protection (although, once again, there is no reason to ensure only a government agency can provide this—a number of Australian universities have at least considered submitting themselves to the Global Alliance for Transnational Education (GATE)—a totally independent non-governmental certifying body based in Washington.) Moreover, it is through their entry that we will be able to make the transition to near-universal higher education, for on current evidence they are capable of operating profitably in selected fields at full fees comparable with HECS. It is thus within our power to lift our skill and credential base as befits the dawning of the knowledge economy, without a major boost in taxpayer funded support for undergraduate education. (Government investment in research is another matter, and I do not touch on that this evening).

The proposal to be more flexible in the use of the name university will have its critics. The word 'university' is a controlled word in

Australia, and it is difficult to imagine the University of Phoenix, for example, getting past any Australian State accrediting authorities. Many of these use criteria that concentrate on input considerations such as the qualifications of the full-time academic staff, the number of volumes in the library, and the research profile. None of these are singly or jointly sufficient to predict a good undergraduate degree, with high levels of student satisfaction and successful graduate placement—criteria included by the Federal Government among others as performance indicators for Australian university education.

We should also be mindful of the fact that there is still an appalling degree of snobbery associated with university education, and any measure that reduces the rarity of a university degree reduces its snob value. There are people who resent the idea of universal higher education, despite the fact that the evidence suggests that, with motivation, a good foundation programme, and a good teaching and learning environment, the percentage of the population that is capable of completing a university degree is probably in excess of 90%.

By further deregulating the higher education sector and removing irrelevant entry barriers to for-profit entrants Australia could significantly expand its export earnings from higher education, as well as making the transition to universal or near-universal higher education a reality, thus strengthening Australia's ability to compete in the knowledge economy. A solid educational base to advanced levels must be a key element in projecting ourselves forward in knowledge economy competition, as footloose capital looks for a low cost safe environment with a strong skills base.

Will this happen? One day it must, because it will happen elsewhere and then we will copy it. But the signs are not good at present. The Federal Government is going into the forthcoming election promising not to further deregulate university fees, thus keeping students and parents safe from price signals and price competition. The Federal Opposition's most recent promise is however extraordinary. It will abolish the right of Australian universities to enrol above quota Australian undergraduates on a full fee basis. Why? Because, we are told, the Opposition does not believe university places should go to the 'dumb and rich'. Of course

the claim that these are the beneficiaries is both offensive and false. And if the place did not go to a full fee-paying student it would not go to anybody else—the place is created by the student tuition fees, and would not exist otherwise.

We are also told these people are 'queue jumpers' because many of them, having paid full fees, do well enough in first year to successfully compete for a HECS-liable place in second year. Not a bad result if you're rich and dumb. And this from a party which, when it was last in government, was rightly encouraging articulation and other transfer and credit arrangements to enable people to transfer from TAFE and reputable private providers into more senior years at university. Some ways of jumping queues, it seems, are better than others.

Ironically, the effect of the Federal Opposition's policy, if implemented, would be to confer an east coast monopoly on Australia's first private, albeit not-for-profit university, Bond University, on the Queensland Gold Coast. Currently Bond must compete for fee-paying Australian undergraduates with one other regional Queensland University, and a number of Sydney- and Melbourne-based universities. But they would be banned from recruiting such students. Imagine the outcry if a conservative government were to confer a monopoly on a private provider, by banning public institutions from competing with it!

The sad thing about the Opposition's policy is not its manifest incoherence. It is not even its wanton interference in university autonomy, although I have not yet been deafened by the cries of Chancellors pointing out that the decision as to whether to continue to admit full fee-paying Australian undergraduates is one for their governing bodies.

The sad thing is that the senior leadership of the Opposition must know that this policy is just silly. One can only assume this pandering to those of their supporters who are driven by envy—if all can't have it then none should have it—and nostalgia for the centrally managed economy, is preferable to pandering to them in other areas of greater macro-significance.

In sum, the best thing any government can do to equip Australia for more rapid advance into the age of the knowledge economy is to facilitate the massification of higher education, and there is no effective or

affordable way of doing this which does not involve further large scale deregulation of the higher education sector, and the removal of the barriers that are inhibiting the birth of the for-profit university in this country.

### **References**

- Chipman, L. 1999, 'Disintegration of an Industry', *Journal of European Higher Education* XXIV (2), pp. 177-186.
- Drucker, P. 1994, 'The Age of Social Transformation,' *The Atlantic Monthly*, November.
- Thurow, L. 1999, *Building Wealth: The New Rules for Individuals, Companies, and Nations in a Knowledge-Based Economy*, HarperCollins, New York.



## Closing Remarks

*Professor Steven Schwartz*  
*CIS Academic Advisory Board Member*

Ladies and Gentlemen we've just heard a very thought-provoking speech by Professor Chipman. I think most of you, when you were listening to that speech, were thinking, 'How does this relate to me?'. And I have to confess that I actually underwent considerable adversity to be here tonight. This rather rude looking figure was my finger and about an hour before tonight's dinner it was being stitched up so that I could be here this evening listening to this speech. I realised that it wasn't just the usual random horrible event that occurs to me, but in fact a microcosm of what Professor Chipman was talking about because I had a choice: I could go to the hospital to have this stitched up and I would be here for breakfast tomorrow, or I could go to the private sector to have this stitched up and actually make it in time for a drink before dinner. I chose the latter!

And I also realised that in that encounter the effects of globalisation were even affecting the local GP, because he offered me a tetanus shot that is actually manufactured in France. He sutured me up with Chinese sutures—I know, I'm a bit worried—but the technique he used he learnt in the UK. He was a living example of globalisation, and I was involved in a living example of freedom of choice. We had a private and we had a public provider—they are allowed to compete, and I, as a customer, am allowed to choose. I think that Professor Chipman is making a similar argument for higher education, and I hope that somebody hears it.

Please join me now in thanking Professor Chipman for his wonderful thought-provoking speech.

THE CENTRE FOR INDEPENDENT STUDIES is a non-profit, public policy research institute. Its major concern is with the principles and conditions underlying a free and open society. The Centre's activities cover a wide variety of areas dealing broadly with social and economic policy. It emphasises the role of markets and other voluntary processes in providing many of the goods and services normally supplied by the compulsory methods of government.

The Centre meets the need for informed debate on issues of importance to a free and democratic society in which individuals and business flourish, unhindered by government intervention. In encouraging competition in ideas, The Centre for Independent Studies carries out an activities programme which includes:

- research
- holding lectures, seminars and policy forums
- publishing books and papers
- issuing a quarterly journal, *Policy*



PO Box 92, ST LEONARDS,  
NSW 1590 AUSTRALIA  
Ph: +61 2 9438 4377  
Fax: +61 2 9439 7310  
Email: cis@cis.org.au

PO Box 5529, LAMBTON QUAY,  
3785, NEW ZEALAND  
PH: +64 4 499 5861  
FAX: +64 4 499 5940

**Council of Academic Advisers**

Professor H.W. Arndt  
Professor Ray Ball  
Professor Jeff Bennett  
Professor Geoffrey Brennan  
Professor Lauchlan Chipman  
Professor Kenneth Clements  
Professor David Emanuel  
Professor Ian Harper  
Professor Max Hartwell  
Professor Warren Hogan  
Professor Helen Hughes  
Professor Wolfgang Kasper  
Professor Kenneth Minogue  
Professor R.R. Officer  
Professor Ross Parish  
Professor Suri Ratnapala  
Professor Steven Schwartz  
Professor Judith Sloan  
Professor Peter Swan  
Professor Geoffrey de Q. Walker

# What Governments Can't Know

The Knowledge Economy and the Market

Lauchlan Chipman

**P**oliticians are confident they can boost the 'knowledge economy'—we have the Commonwealth Government's 'Backing Australia Ability', federal Labor's 'Knowledge Nation', Queensland Labor's 'Smart State' and Tasmanian Labor's 'Intelligent Island'. But are governments well placed to foster the infusion of different types of complex knowledge to create new or better goods and services?

The so-called knowledge economy is one in which comparative advantage is overwhelmingly secured by the infusion of temporarily unshared knowledge into the design, production, and distribution of goods and services, regardless of the nature of the industry in which the enterprise operates. Therefore a knowledge economy is not like a wool economy or a steel economy, or even a service economy, because the knowledge economy tag refers to how value is predominantly added, rather than the types of products and services that are generated and traded.

Government regulation and incentives change the behaviour of the knowledge economy's real actors. We risk substituting government guesses for the decentralised knowledge of universities, business and other organisations that actually produce knowledge-intensive goods.



**LAUHLAN CHIPMAN** is Founder and Principal of Lauchlan Chipman and Associates, an independent higher education and management solutions consultancy. He is a former Vice Chancellor of Central Queensland University, and an Emeritus Professor of the University of Wollongong. He is also a Fellow of the Australian College of Education, a Fellow of the Australian Institute of Management, and a member of the Academic Advisory Board of The Centre for Independent Studies.

**THE JOHN BONYTHON LECTURE SERIES** was inaugurated by The Centre for Independent Studies in 1984 to honour the founding Chairman of its then Board of Trustees. Each year the Centre sponsors a lecture to examine the relationship between individuals and the economic, social and political forces that make up a free society. The lectures are published as part of the CIS Occasional Papers series.

ISBN 1-86432-063-X



9 781864 320633



Occasional Paper 77  
ISBN 1 86432 063 X

ISSN 0155 7386

A\$8.15 NZ\$8.95

[www.cis.org.au](http://www.cis.org.au)