The Economic Bases for Regulating Philippine Higher Education

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The Challenge

How ideally should Philippine higher education be organized
such that its institutions and incentive structures

(a) support the achievement of
(*i*) the national goals for which higher education may be both a means and an end
as well as
(*ii*) higher education's own sectoral social welfare objectives

(b) ensure that higher education institutions (HEIs) perform their societal roles

(c) are cognizant of widely diverse contexts and settings?

The Aspirations

Implicitly acknowledged in the statements and the proposed solution:

Higher education outcomes are a distinct dimension of human flourishing, but also contribute to its full realization

so that higher education outcomes are ends worthy of pursuing in themselves

The Aspirations:
National Goals

The national goals that modern Philippine society sets for higher education:

a. develop the country's human capital in breadth and depth
to make the Filipino workforce more globally competitive and
future-proofed against the technological and other disruptions of the
21st century (so that the Philippines would be able to maximize its
demographic dividend)

b. transmit Filipino culture, values, history, and identity to future
generations (in a mature-adult sense)
to ensure the cohesion of Philippine society and
inculcate love of country

The Aspirations:
Sectoral Objectives

The sectoral social welfare objectives of higher education are to improve:

a. access to education
b. the efficiency of operations and delivery of higher education services
c. the distributional equity of schooling opportunities
d. education quality, learning outcomes, and student success

The Aspirations:
HEI Roles

The roles that modern society expects HEIs to perform are to:

a. confer academic degrees
(certifications that graduates have the necessary life skills for human flourishing and are adequately prepared for the world of work)

b. conduct research to push out the boundaries of knowledge
(HEIs are a society's vanguards and primary repositories of knowledge)

c. enhance the economic prospects of the HEI's geographic area
(among society's institutions, HEIs have the widest and deepest intellectual resources)

The Settings

There is wide diversity in

- the local conditions of communities
- visions and missions of HEIs
- the aspirations of students and families, private industry, local and national government, other stakeholders

⇒ A one-size-fits-all, top-down administrative and governance structure cannot be the mode of provision

The Market Constraints

Higher education is a club good, not a pure public good

Types of Goods by Consumption Benefits		
Benefits	Excludable	Non-Excludable
Rival	Private Goods	Common-Resource Goods
Non-Rival	Club Goods	Public Goods

Rivalry: a person's consumption of the good reduces the amount available for others

Excludability: people who have not paid for the good can be prevented from consuming it

The Market Constraints

Higher education is a club good, not a pure public good

Types of Goods by Consumption Benefits		
Benefits	Excludable	Non-Excludable
Rival	Private Goods	Common-Resource Goods
Non-Rival	Club Goods	Public Goods

Examples:
Private Goods: a cookie
Common-Resource Goods: firefighting service; fish in public waters
Club Goods: a country club; a Netflix subscription
Public Goods: national defense; sunset in Manila Bay

The Market Constraints

Higher education is a club good, not a pure public good

Types of Goods by Consumption Benefits		
Benefits	Excludable	Non-Excludable
Rival	Private Goods	Common-Resource Goods
Non-Rival	Club Goods	Public Goods

Higher education is a club good.

Excludability: an HEI can restrict admission to its program offerings

Nonrivalry: As long as the learning environment is not congested, students may *simultaneously* attend the same lectures, study the same learning modules, do the same assigned homework, use the same school facilities

The Market Constraints

Higher education has external or spillover effects

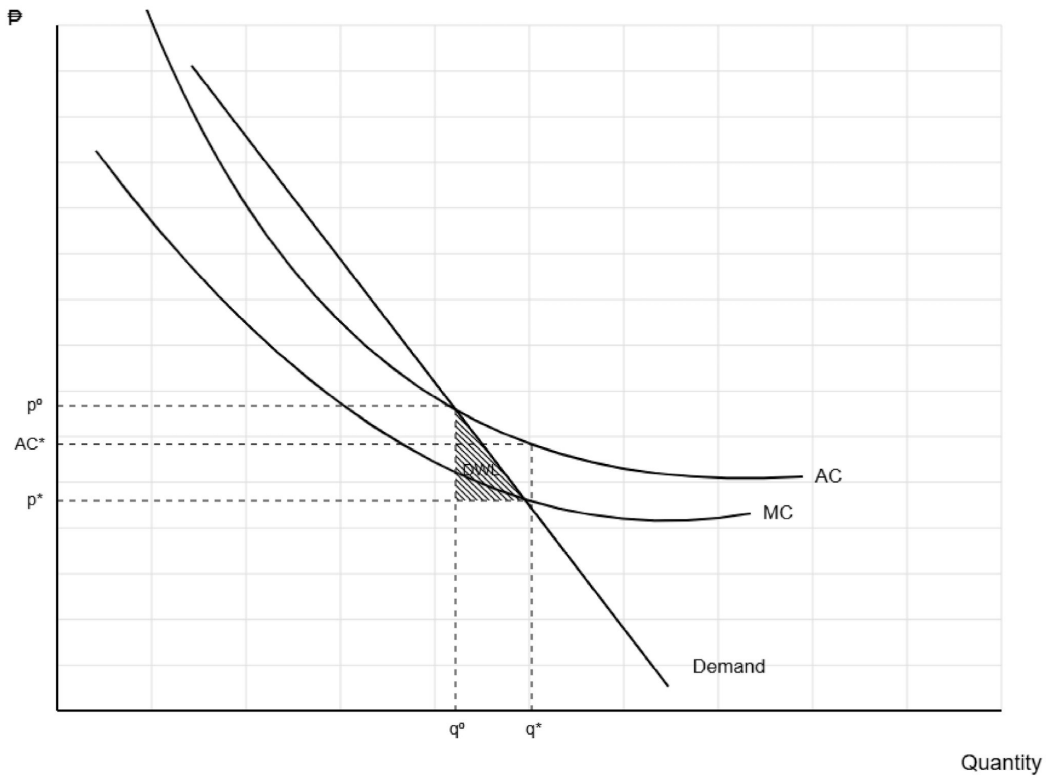
- Educated people are more informed;
  are generally civically responsible and engaged citizens
- Public information is easier to disseminate among educated citizenry
- A more educated workforce is more productive, which sets an economy on a higher growth trajectory
- Educated persons may apply their skills for ends either favorable or detrimental to the common good

The Market Constraints

HEIs have a monopolistic cost structure

- Upfront fixed costs are large in proportion to total cost
  - To set up a campus, an HEI has to develop a large tract of land; construct and maintain buildings with offices, classrooms, laboratories, and other facilities; provide support infrastructure (roads, foot-traffic pathways, parking spaces, potable water and waste disposal systems, the internet backbone)
  - At (initial) low enrollment levels, variable costs (salaries and wages, electricity and utilities) are minuscule relative to fixed costs

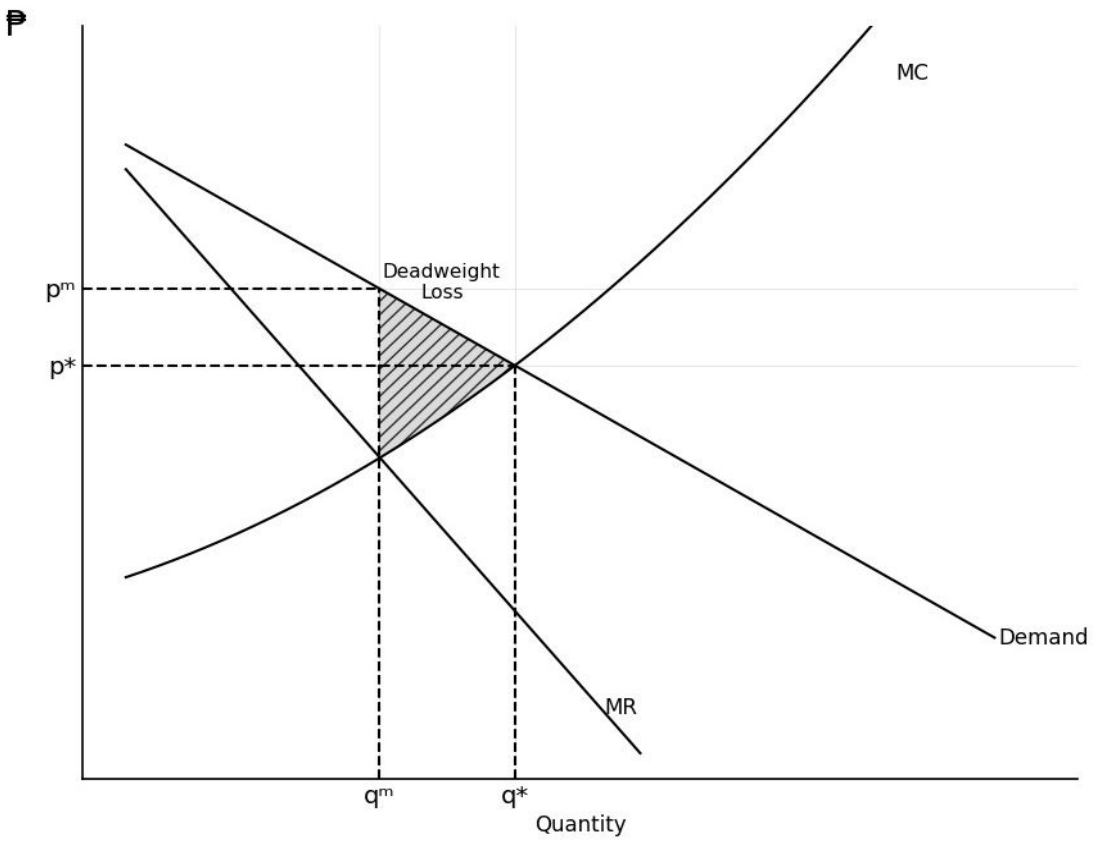
The Market Constraints



HEIs have a monopolistic cost structure

- If a *natural* monopoly charges at $p^* = MC$, it operates at a loss equal to $(p^* - AC^*) \cdot q^*$
- If it charges the zero-profit price $p^\circ = AC$, there is a deadweight loss (the shaded area): some students lose access to the higher price

The Market Constraints



HEIs have a monopolistic cost structure

- If not a natural monopoly and the HEI charges at the profit-maximizing p^m (where $MR = MC$), there is a deadweight loss (shaded area)

The Market Constraints

Higher education is beset with information asymmetry

- Education-financing schemes have to contend with adverse selection and moral hazard problems
  - Adverse selection: one party in a transaction has more or better information about a pre-transaction attribute (a hidden trait)
    - Example: High (default) risk students are more likely to apply for a loan, but HEIs cannot perfectly screen them from low-risk students; the resulting higher default rate increases interest charges, making the loan program less attractive to the low-risk students
  - Moral hazard: one party in a transaction is unable to observe the post-transaction behavior of the other party (a hidden action)
    - Example: Students with full and unconditional scholarship grants may slack off and underperform, because they don't bear the costs of school fees

The Market Constraints

Higher education is beset with information asymmetry

- Education is both an experience good and a credence good

Goods differentiated by quality

- Search goods: quality can be evaluated before purchase
- Experience goods: quality can be evaluated during consumption
- Credence goods: quality can be evaluated only well after consumption, if at all

The Market Constraints

Higher education is beset with information asymmetry

- Education is an experience good
  - Examples: books, movies, travel-tour packages
  - At the point of sale, the buyer cannot assess quality (what the impact of the consumption experience will be)
  - Quality depends on the person's predispositions: how willing is she to accept the premises on offer and how immersed will she be in the experience?

  - The consumer who discerns – for herself – the quality of her *unique* consumption experience, which depends on her predispositions and extent of engagement/immersion

The Market Constraints

Higher education is beset with information asymmetry

- Education is an experience good
  - When a student is admitted to an academic program, she does not know its effects on her growth and development – it is her school that has better information about the value proposition on offer
  - Schooling is likely to be more transformative, the more fully engaged the student is with her school's curricular and co-curricular activities

The Market Constraints

Higher education is beset with information asymmetry

- Education is a credence good
  - Examples: medical consultations, surgical procedures, car repair services, herbal remedies, dietary supplements
  - The consumer does not know exactly what she needs and how to satisfy it
  - After the initial assessment, the expert has a better idea of the consumer's problem and how to solve it

The Market Constraints

Higher education is beset with information asymmetry

- Education is a credence good
  - Credence-good markets are characterized by:
    - being expert-driven
    - consumers having to rely on the trustworthiness and honesty of providers – hence, reputation of the provider matters
    - unreliable feedback
    - being prone to fraud and the total breakdown of the market
  - These characteristics apply to the higher education market
  - Moreover
    - low passing rates in licensure exams
    - inability to be promoted beyond entry-level jobs
    - additional training to meet productivity standards

Government-Provision Constraints

High risk of government failure

- Government intervention results in a worse outcome

Government bureaucracies tasked with operational day-to-day missions tend to be

- neither responsive to market forces nor concerned about inefficiencies
- overburdened, bloated, or both
- distracted by political firefighting
- vulnerable to temporal changes in government preferences, which manifests in policy volatility, unstable governance, and uncertainty for stakeholders
- provided with discretionary powers, which opens opportunities for exploitative, self-serving behavior

Direct state provision tends to favor a one-size-fits-all, top-down administrative and governance structure

Government-Provision Constraints

High risk of government failure

- Government intervention results in a worse outcome

Then there is the high cost of public funds

Marginal Cost of Public Funds	
Developed Countries	0.3
Malaysia	1.2
Thailand	1.2–1.5
Philippines	**2.5**

Every peso collected in taxes costs the Philippine economy ₱3.50 (1 + 2.5) in lost output

Government-Provision Constraints

High risk of government failure

- Government intervention results in a worse outcome

The 2024 General Appropriations Act (RA 11975) allocated ₱128.2 billion for state universities and colleges (SUC)
This represented a ₱448.7 billion loss in the GDP

Questions:

- What is the return on investment on the SUC allocation?
- Did projects with higher ROIs go unfunded or underfunded as a consequence?
- Wouldn't the funds have been better allocated to support the research and brain-trust functions of HEIs?

Market Regulation

- Claim: A market-based solution may be less detrimental than government provision to the desired social outcomes for higher education
  - Culture and practices that result in government failure may be deeply entrenched in the country's (not just the government's) institutional infrastructure
- Proposed solution: an independent regulatory agency

Market Regulation

Independent regulatory agencies defined from other sectors (e.g., telecommunications, energy and utilities, healthcare financing):

Government entities that are

(a) legally distinct and functionally detached from government departments

(b) specialized in their regulatory missions

(c) charged to pursue regulatory goals specific to their sector or industries

Market Regulation

Advantages of independent regulatory agencies over line-function bureaucracies (evidence from other sectors):

- By design, they are insulated from day-to-day operations of governing and temporal changes in government preferences
- They are able to project administrative stability and trustworthy governance within circumscribed regulatory jurisdictions
- Staffed by experts in specific fields of regulation required by the sector or industry, they are better able to carry out their regulatory missions and have better chances of achieving their regulatory goals

Market Regulation

Design of regulatory framework

- Empower the agency with a clear mandate to drive progress toward the nation's aspirations for higher education (with annual public reportorial requirements)
- Align stakeholder incentives with these aspirations
- Specify strict rules of behavior
  - Arms-length relationships with all stakeholders
  - Transparency and public accountability in all transactions and decision making
  - Fairness to all stakeholders
- Prohibit regulatory capture, time-inconsistent policy making, government interference
- Require the agency to develop interventions to address market failures
- Require the agency to be staffed by technical experts in regulation and higher education