

**Implications and Prospects of Reforming the Market for Secondary  
Education in the U.S.**

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## I. INTRODUCTION

There is little disagreement today among Americans that the current system of elementary and secondary public education in the United States is in need of significant improvement. Indeed, recent results of standardized tests have placed American 12<sup>th</sup> graders near the bottom among students from 21 countries in the areas of mathematics and science.<sup>1</sup> In his most recent State of the Union Address, President Clinton reaffirmed his previous statements that the improvement of public schools should be “[Americans’] highest priority.”<sup>2</sup> Recently, the Clinton Administration has proposed measures such as hiring an additional 100,000 teachers to reduce overall class sizes as well as increasing federal spending to provide greatly needed repairs to many of America’s schools. It is clear that improving the quality of public education in America has become a very important political issue. However, despite the general consensus that America’s public schools are not performing well, there is a profound and fervent debate now taking place on precisely what should be done to improve the present state of public education in the United States.

The purpose of this paper is to address the complex issue of public school reform. I will focus primarily on the rather generic concept of school *choice*, which will inevitably be defined and redefined, throughout my analysis. In doing this, I will first examine the structure and composition of the market for education in America. I will then briefly look at some theoretical approaches to educational reform. Lastly, I will examine specific reform proposals that draw on some of the many varying concepts of *choice* as well as currently enacted projects that have a form of *choice* as their focus. My analysis will focus on the likely effects of these proposals on the main actors in the educational system- students, teachers, and government bureaucrats.

## II. THE MARKET FOR EDUCATION

An effective discussion of education reform simply cannot take place unless the parties involved have an understanding of the current educational marketplace in the United States. As is the case of other markets in the “real” world, it becomes clear that imperfections exist within the market for education. One arises simply from the fact that public schools are not at all integrated in a truly competitive system. In many isolated, rural areas, a single public school is the only feasible educational choice offered to parents and students. Thus, public schools in these areas are able to exercise monopoly power over their customers, the purchasers of education. In many urban areas, public schools are interspersed along with private schools. However, because of the high cost of many private schools, public schools are still able to exert monopoly power over families who cannot afford these educational alternatives. Through these two basic examples of inefficient irritants in America’s public school system, one begins to realize that there are inherent problems in the form and structure of education in America. The remainder of this section will draw on more specific scholarly analyses and critiques of these problems.

Perhaps the best way to understand the current educational system in the U.S. is to examine the areas in which market imperfections are curtailing socially optimal outcomes. In his two widely read books, *Capitalism and Freedom* and *Free to Choose*,<sup>3</sup> Milton Friedman attempts to do precisely this. As one of the most outspoken critics of the current educational system in the U.S., Friedman offers in his works an intuitive economic analysis of educational problems in America. With no apologies, Friedman examines the educational system from a perspective greatly biased toward a free-market

ideal. While this approach is indeed one-sided, an economic evaluation of the educational system would be incomplete without investigating this view.

Before the mid-1800s, America's schools were primarily locally-centered, private institutions. Friedman argues that this system was replaced by the current system of centralized public education not because of choices made by parents but rather because of pressure from self-interested teachers and administrators, and also because of arguments made by well-meaning intellectuals (1979, 154). This, according to Friedman, resulted in the evolution of a highly bureaucratic educational system. This centralization, he argues, has caused "a reduction in the ability of consumers to choose, and an increase in the power of producers" (1979, 157). In this analysis Friedman alludes to one of the main characteristics of the market for public schools. In effect, while students' and parents' logical objectives are to maximize overall student performance and utility as well as the performance of schools as a whole, teachers and administrators may be motivated by other self-serving objectives. If public schools have some degree of monopoly and if the operators of schools can be assured of state and federal aid without much accountability, then these self-serving objectives are more likely to win over the less influential objectives of students and their families (1979, 172).

Friedman also discusses the consequences of income differences among consumers of education given the current system of public and private schooling. He asserts that wealthy families have greater educational opportunities today than poor families because the affluent can afford the double-payments involved in sending a child to a private school. In effect, families with children enrolled in private schools must first pay the government the amount required for financing their "share" of public schooling

and they must also pay private school tuition (1962, 93). Also, the wealthy can more easily relocate to neighborhoods in which public schools are of better quality. This inevitably results in segregation within public schools, which is based directly on families' income. Those who cannot afford to move to districts in which schools are of acceptable quality are left together in an abyss of poor quality education. To make matters worse, Friedman argues that there is also inequality in the marginal educational value of money spent in wealthy as opposed to poor school districts. In poorer districts, which are more likely to have higher crime rates, more money must be spent on non-educational costs such as security and less on actually educating students (1978, 158).

Importantly, Friedman's analysis provides the argument that a correctly functioning, competitive market will allow for an adequate exchange of information between the parties involved in the various transactions. In effect, as one moves farther away from a model of perfect competition toward a system with more characteristics of oligopoly or monopoly, it becomes more difficult for preferences to be revealed through normal market functions. Charles Manski (1992) of the Institute for Research on Poverty at the University of Wisconsin summarizes the factors leading to inadequate information exchange in the education market as well as forces affecting the supply (the structure and type) of education provided:

The theoretical argument for *choice*, as stated by Milton Friedman and as espoused today, is a straightforward application of elementary principles of classical economics: Tax support of public schools distorts the incentives faced by both the consumers and producers of schooling. Consumers incentives are distorted because the residents of a given school district are encouraged to enroll their children in that district's public schools rather than in private schools or out-of-district public schools, where they may have to pay fees of several thousand dollars per year. Producer incentives are distorted because the price differential between a district's public schools and other educational alternatives gives the public

schools local monopoly power over district residents; hence the public schools can attract students even if they do not provide the type and quality of education that families want.<sup>4</sup>

Given a system in which it is difficult for parents to place their children in schools of their choosing, consumers of education are unable to adequately reveal their preferences through market mechanisms. A system in which these distortions do not exist would allow dissatisfied parents to convey their wishes by choosing *not* to enroll their children in these schools. Hence distortions in demand are inherent in America's present educational system.

Manski also refers to supply distortions within the same system. Given that public schools are controlled by local, state, and federal government and that teachers' objectives are voiced primarily through teachers unions, the quality of education is inevitably influenced by third parties. Schools are also required by law to meet certain government criteria. These criteria include sometimes rigid curriculum controls as well as requiring teachers to be licensed.

Private schools, operating more within a competitive marketplace, have far fewer controls and restrictions placed upon them. This, in turn, has caused the structures of the two systems of education to greatly diverge from one another. Many proponents of private school educational methods believe that it is precisely this freedom from governmental controls and restrictions that allow private schools to successfully compete in a system in which the barriers to consumers in purchasing private education are significantly higher than those for purchasers of public education. Manski states, "a series of studies comparing public and private schools...have interpreted available achievement data as showing that private schools, especially Catholic ones, do a better

job of educating their students than do public schools” (1992, 8). If private schools are indeed outperforming public schools, one must ultimately ask if the differences in supply-side factors such as the looser regulation of private schools are not at least part of the cause.

Yet, few people would argue that removing *all* educational regulations in public schools would be an acceptable (or politically feasible) policy to implement. Few would also argue that teachers unions could (or should) be eliminated. However, when assessing the educational marketplace, one must realize that the existence of these factors tends to move the educational system toward a more monopolistic structure. James Fallows<sup>5</sup> (1989) writes that “licensing essentially [gives] small groups the right to regulate their own competition” (135). The end result of licensing is to raise the barriers to enter the licensed workforce and thus to raise the returns to those who are fortunate enough to be licensed. Thus, Fallows argues that it is in teachers unions’ best interest to “...fight hard to keep ‘unqualified’ people, those without education degrees, out of their profession, and then fight equally hard against competence tests and outside assessments of how qualified teachers are” (163). Consequently, forces in the demand and supply sides of the education market tend to distort and reduce the offerings of schools to students and their families.

Upon inspection of the market for education in the United States, it becomes clear that many powerful forces are reducing the power of consumers and increasing the power of the producers of public education. These forces affect both the supply and demand sides of the educational marketplace. Based on the above analysis, one may infer that the major structural problems facing America’s educational system today result from the

relatively high degree of monopoly power that public schools in the U.S. are able to wield over students and their families who are the ultimate purchasers of education. Increased competition among schools intuitively appears to be at least a partial solution to these problems. Thus, an analysis of the effects of increased competition on the education market becomes necessary.

### **III. THEORETICAL AND EMPIRICAL EFFECTS OF INCREASED COMPETITION ON PUBLIC SCHOOLS**

This section will briefly discuss the theoretical effects of increased competition on public schools as well as on the overall market for education. It will analyze some empirical findings based on works by economist Caroline Minter Hoxby (1994) of Harvard University. The section will approach the question of the effects of increased competition from two perspectives. The first will focus on the effects of increasing the level of competition solely among public schools themselves. The second will then factor private schools into the equation, and discuss the implications of competition between these two distinctly different educational entities.<sup>6</sup>

Hoxby's paper on competition between public schools predicts increased sorting of students among schools, higher productivity (better student performance per input), and decreased incentives to send children to private schools as the primary intuitive effects of increasing competition among schools. The increased competition, she argues, would result if students and parents were given greater degrees of choice in their schooling.<sup>7</sup> Her measure of student performance is based on educational attainment, wages, and Armed Forces Qualifications Test scores. All effects are assumed to take place in the long-term, as a result of expecting slow adjustments to changes both in the bureaucratic public sector as well as by parents and students themselves.

In general terms, Hoxby finds that increased competition among public schools does lead to greater student productivity. She finds that students' performance improves as seen by increased educational attainment, higher post-schooling wages, and higher test scores overall. These improvements occur in the poorest as well as the wealthiest school districts. Hoxby finds evidence of increased sorting (i.e. some students leaving schools for other educational opportunities) but she does not find this to be harmful to disadvantaged groups.

Hoxby's study also analyzes "real" statistical changes resulting from greater competition. Specifically, she studies the effects of increases in competition among public schools generated by changing the composition of a metropolitan school district from two equal-sized to ten equal-sized school districts. This change, she says, results in a decrease in per-pupil spending of \$219, an improvement in educational attainment of .3 years, and an increase in post-schooling wages of 5%. The effect on private schools is, in fact, inverse as is predicted in Hoxby's thesis. Consequently, the structural changes in the public school district results in a decrease in private school enrollment of 2%. In effect, Hoxby finds that increasing competition among public schools results in lower per-student costs and better overall student performance.

In her analysis of the competitive effect of private schools on public schools, Hoxby focuses on religiously affiliated schools because these make up over 87% of the total private school enrollment. Hoxby theorizes that increasing competition between private and public schools will result in greater spreading of information about schools' productivity. This should result, she argues, because a situation in which public schools are forced to compete directly would result in total public school budgets depending

positively on productivity. If a public school is not productive, less education will be demanded from it and more money will be spent on private rather than public schools. Thus, normal market mechanisms would express consumers' preferences.

Hoxby also empirically analyzes the effects of competition from private schools on educational attainment and test scores. She finds that a 10% increase in the private school enrollment share results in .9 years of additional educational attainment, and a 7% increase in students' test scores. Most importantly, She finds that "for an equal movement of students, competition from private schools has approximately double the positive effect on public school students that competition between public schools has" (1994, 26).

The studies done by Caroline Minter Hoxby strongly suggest that increasing the degree of competition facing public schools will result in greater student output per unit of input. Given that competition will increase the effectiveness of public schools, the important debate then revolves around precisely how competition would best be introduced to the current system of public schooling in America. The last section of this paper evaluates some of the most popular proposals and current projects of educational reform within the United States. These evaluations are based on the previous analyses of the education market and the effects of increased competition on public schools.

#### **IV. ANALYSIS OF PROPOSED REFORMS AND CURRENT REFORM PROJECTS**

Most of the current proposals of educational reform as well as projects taking place in cities throughout America are based on the idea of *choice*. School *choice* has come to mean very different things to different groups and individuals. However, *choice* in general has come to mean decreasing the level of distortions in the supply and demand

side of the educational market by reducing, to some degree, the monopoly power held by the public school system in America. This section will discuss the effects of Friedman's proposed voucher system, drawing conclusions from the voucher experiment currently taking place in Milwaukee as well as on data based on an economic model developed by Manski. It will also discuss examples of school *choice* currently taking place in Cambridge, Massachusetts, and Brooklyn, New York. Lastly, it will briefly discuss the relatively recently popularized idea of charter schools, which appear to be gaining tremendous momentum in the United States.

Friedman's proposal of educational vouchers for students who enroll in private schools is by far one of the most drastic educational reform proposals, as well as one of the most hotly debated. His proposal calls for a voucher, to be valued at the cost of educating a student in the public system, to be given directly to parents for use in providing their child with whichever educational opportunities they wish. This particular system of *choice*, according to Friedman, would result in the removal of distortions in the educational market. He argues that because parents could freely choose where to send their children, information would be adequately transmitted, and consumer preferences would be better revealed. Moreover, the voucher would greatly increase competition among schools thus increasing overall productivity and producing higher returns to educational investment. Friedman goes so far as to suggest that the freeing up of such large sums of capital to be specifically invested in education would inevitably result in a dramatic change in the structure of schools throughout the U.S. In effect, schools that could no longer compete would exit the market and new and improved schools, offering a

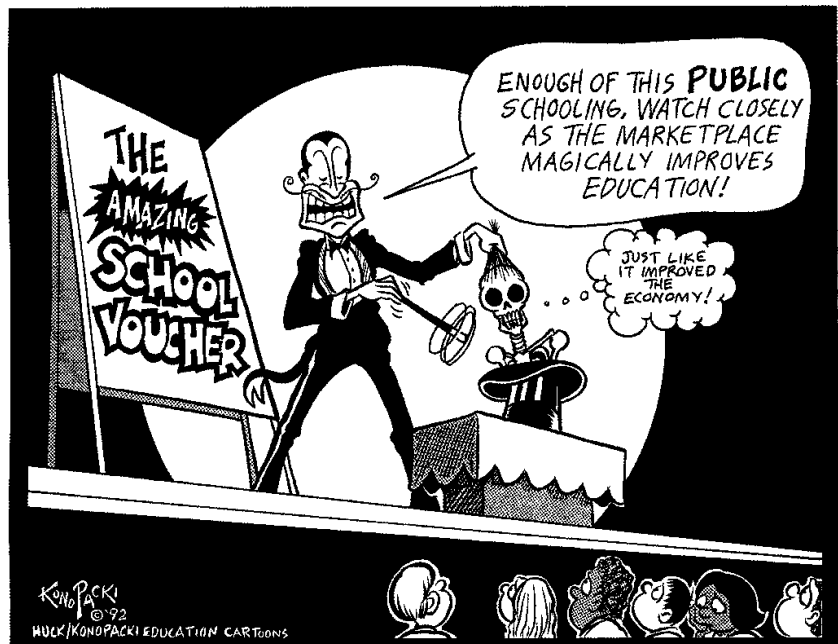
new and improved “product” would replace them. Schools would be forced to model themselves after consumers’ rather than producers’ wants.

In “*Educational Choice and Social Mobility*,” Charles Manski states that “*Choice* advocates can argue that a voucher system is inherently superior, on economic grounds, to public-school finance only if they presume that education approximately fits the assumptions of classical economics” (1992, 14). Because of the difficulty in assessing this, Manski develops an empirical model of vouchers and attempts to derive the probable effects of vouchers through this model. Manski’s cites two results as important in determining the value of educational vouchers. First, the effects of vouchers on low-income youth appear to be neither entirely positive nor negative. In effect, vouchers help some poor students (i.e. those who leave the public schools) and hurt others (those who stay). Second and most important, Manski finds that given even the most positive possible outcome in his model, educational vouchers simply do not come close to equalizing educational opportunities across income groups. These findings are given further validity because his model was slightly biased *toward* vouchers.

I do not feel, however, that one can decide absolutely that Friedman’s idea of vouchers is inadequate solely based on Manski’s findings. Many proponents of vouchers cite Milwaukee’s *choice* plan, which, since 1990, has provided 1000 children from low-income families with vouchers to attend non-religious, private schools.<sup>8</sup> This plan, according to Peterson and Noyes (1996), was severely weakened from Friedman’s original concept because of severe limitations imposed by the state and local legislatures. However, they state that the program has developed into a definite success. They note that “the number of students participating in the choice program more than doubled over

the first five years of the program. The number of participating schools increased from seven to twelve, giving parents somewhat greater choice” (49). Based on their analysis, it appears as though Milwaukee’s system of *choice* may indeed have benefits.

However, it is important to note that many of the voucher system’s greatest opponents point to the Milwaukee experiment as evidence that Friedman’s voucher system is incredibly harmful. One can see in the cartoon below that there is widely held skepticism that market mechanisms based on educational vouchers should have any place at all in determining the fate of public schools in America.<sup>9</sup>



Given such skepticism, it appears as though educational vouchers have little political chance of being adopted in the way that Friedman has hoped for. My analysis now turns to reform projects that have been enacted and are currently operating in several of America’s cities.

John Chubb and Terry Moe (1990),<sup>10</sup> two highly influential advocates of *choice* programs, provide an overview of two current choice programs in Cambridge, Massachusetts, and East Brooklyn, New York:

In Cambridge, which struggled through “white flight” from public to private schools throughout the 1970s and early 1980s, a program was developed in which neighborhood school district boundaries, per say, were eliminated. Parents and students in Cambridge now select in order of preference up to four schools. Along with these preferences, racial balance is taken into account, as is proximity in determining the schools in which children will be placed. By far, they state, most students receive either their first or second choices.

The results in Cambridge, according to Chubb and Moe, are that racial balance has been restored in the public school system in Cambridge. Before the system was enacted, they argue, whites were “bailing out of the system into private schools and other districts” (210-211). Competition among public schools has increased dramatically and the programs offered by public schools have diversified, effectively offering greater choice to students and parents. Consequently, “by 1987, 89 percent of the district’s newly entering students (kindergarten aged) were choosing public schools, compared with 78 percent in 1979” (211).

In 1973, district number four in East Harlem, New York ranked last in reading and mathematics among thirty-two school districts in New York City. Beginning in 1974, leaders there began to create alternative schools built around differing themes, philosophies, and areas of interest. Some of the schools that arose were the Academy of Environmental Science, the Jose Feliciano Performing Arts School, the Isaac Newton

School for Math and Science, Rafael Cordero Bilingual School, the School of Science and Humanities, along with many others. Due to economic constraints, many of the schools had to share buildings. However, the schools were given relative freedom in admissions, programs, methods, and academic structure.

The results of the Cambridge program can be seen most significantly in student performance. “While only 15.9% of the district’s students were reading at or above grade level in 1973, 62.6% were doing so by 1987. [District 4’s] scores now put it around the middle for New York City, rather than at the bottom” (214).

The results cited by Chubb and Moe in the school *choice* systems in Cambridge and the East Bronx should greatly encourage advocates of school *choice* programs. It appears as though the Cambridge and East Harlem systems have indeed been successful. One then logically asks ‘from where exactly does this success come?’ It appears as though, given the initial argument for increased competition among schools, that the higher levels of competition created by expanded choice in East Harlem and Cambridge are most likely responsible for greater student productivity. In effect, increasing students ‘and parents’ ability to choose between schools has reduced the demand distortions, and the supply distortions have been reduced by allowing schools to have greater choice as to their educational offerings.

Perhaps as a result of these and other successes, charter schools- legally independent schools that operate using tax dollars- are becoming very popular among advocates of *choice* in America.<sup>11</sup> Currently in Milwaukee, more than two dozen applications have been submitted to establish charter schools. The mix of applicants includes newly proposed schools as well as existing private schools. These schools wish

to remove many of the classical restraints that are placed on public schools (i.e. demand- and supply-side distortions). One of the most controversial of these is the desire by administrators to be able to legally hire and fire employees without being required to negotiate with teachers unions or the Milwaukee Public Schools (MPS) administration. The argument behind this request is that schools and teachers will increase offerings to students if restraints that create and exploit public school monopoly power are removed. Producers, in effect, will be held more accountable for consumer satisfaction, and should consequently provide a better product.

Also proposed in the Milwaukee charter plan is government funding by which each charter school would receive an amount of money (currently set at \$6100) for each child who chooses to enroll. Each additional child who chooses to enroll in a charter school would therefore cause a redistribution of resources from the traditional public school system to the charter school. Clearly, this incorporates some of the ideas of Friedman's proposed voucher system. However, it does not appear at this time that parents would be able to add their own money to the public funding, and they would not receive a voucher directly. Thus, this program appears to promote greater equality of educational opportunity for wealthy and poor students than Friedman's original voucher proposal.

Opponents to Milwaukee's proposed charter system argue that MPS would be devastated by these competing schools. They argue that MPS would perform worse with increased competition because the best students would be more likely to leave for charter schools leaving poor-performing students behind in a weakened public school system. Caroline Hoxby, as previously noted, does not find this to be the likely outcome.

However, it is difficult to envision a true Pareto improvement resulting from *any* drastic changes in the public education system including charter schools. It is likely that some students and their families would suffer from deviation from the status quo.

## **V. CONCLUSION: PRESCRIPTIONS FOR CHANGE**

Given the relative unfeasibility of satisfying every party's wants in public school reform, one must ask what the *most* socially optimal options are. The diagnosis of public schools in America today appears both on intuitive as well as empirical grounds, to be an overall lack of competition and over-regulation. The prescription for change must include both increasing competition as well as producer accountability and somewhat decreasing government regulation. However, policymakers must be aware that incorrect amounts of this medicine could result in the ultimate demise of their patient. Based on the observed results in East Harlem, it appears that charter schools may provide the correct dosage. However, as shown in Cambridge, the schools must also remain sensitive to issues such as poverty and diversity. It does not appear that Friedman's free-market cure would provide the benefits to public schools that he envisioned without creating at least some serious redistribution problems. However, any successful policy of extensive public school reform must include decreasing the monopoly power currently held by the producers of education.

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FOOTNOTES:

<sup>1</sup> **The New York Times**, April 19, 1998 (A 19).

<sup>2</sup> **The New York Times**, January 28, 1998 (A 19).

<sup>3</sup> **Friedman Milton**, Capitalism and Freedom  
University of Chicago Press, 1962 (pp. 85-107).

**Friedman, Milton and Rose B.** Free To Choose  
Harcourt Bruce, 1979 (150-188).

<sup>4</sup> **Manski, Charles F.** “Educational *Choice* (Vouchers) and Social Mobility”  
Institute for Research on Poverty, UW-Madison. Discussion Paper no 972-92, 1992 (p.7).

<sup>5</sup> **Fallows, James.** More Like Us  
Houghton Mifflin Company, 1989 (pp. 135-163).

<sup>6</sup> This section will draw heavily from:  
**Hoxby, Caroline Minter.** “Does Competition Among Public Schools Benefit Students and Taxpayers?”  
NBER working paper series, no. 4979, 1994.

**Hoxby, Caroline Minter.** “Do Private Schools Provide Competition For Public Schools?”  
NBER working paper series, no 4978, 1994.

<sup>7</sup> For now, I will leave the concept of *choice* in the most general sense, as an analysis of different possible *choice* systems will occur in the next section

<sup>8</sup> Information on the Milwaukee *Choice* plan is taken from:  
**Peterson, Paul E., and Greene, Jay P.** “School Choice in Milwaukee”  
Public Interest no.122, 1996 (pp.38-56).

<sup>9</sup> **Lowe, Robert and Miner, Barbara.** “Selling Out Our Schools”  
Rethinking Schools Publications. 1996, (p.5)

<sup>10</sup> **Chubb, John and Moe, Terry.** Politics, Markets, and America’s Schools  
Washington D.C. 1990, (pp. 206-229).

<sup>11</sup> **The Milwaukee Journal/Sentinel**, “City plan for charter schools not far off”  
19 April, 1998. (A 10).