

WHO NEEDS UNIVERSITIES?*

An alien landing on Planet Earth with a view to studying law and reading successive editorials of this *Reporter* might well conclude he/she/it/other had landed on the wrong planet. How are students, academics, their managers and regulators regarded according to this *Reporter*? Students, it seems, bear a strong resemblance to eggs, after all ‘egginess mattered in the outside world. Big eggs got big jobs. Medium eggs got quite good jobs ... small eggs were quietly forgotten’.¹ Anyway egg-like students are the lucky ones if another headline ‘MAKING STUDENTS SUFFER’ is to be taken literally.² Of course, life for academics must be better than this. Well, not according to some of the multiple choice options put forward in Module 1 of the Modern Educational Technology unit. According to this, possible definitions of a professor include ‘a. The living dead’; and of a lecturer include: ‘a. The obvious choice when any unrewarding, mundane or uncongenial work needs to be done’.³ These options must be wrong anyway because according to a government minister it seems that academic staff are believed capable of eating the bark from the trees before giving up teaching and research.⁴ As for their managers, sadly, according to this same *Reporter*, they appear to suffer from ‘gross personality disorders’.⁵ Regulators, such as the members of the RAE panel are compared with ‘sacrifices in an Aztec temple’ that we deliciously anticipate pampering before ‘we slit their throats and eat their hearts’.⁶ Our fictional alien will by now have rapidly taken off for a more congenial environment perhaps to be found on one of the more hospitable moons of Jupiter.

There has to be tremendous sympathy for much of this.⁷ As a cartoon spotted in a colleague's room put it: ‘When up to your backside in alligators it is very difficult to remember that the original objective was to drain the swamp’.⁸ Yet with all the tremendous intellectual powers available to an institution such as the Society of Legal Scholars it does matter that we speak up with a reasoned case, and put forward practicable solutions. Whilst the focus of much writing is upon pedagogical visions of the law school, such writing is often less clear on issues such as who will foot the bill, unless, of course, it is to be the state (in other words, all of us).⁹ Certainly,

¹ *SPTL Reporter*, Spring 2001, p.1.

² *SPTL Reporter*, Winter 2000, p. 1.

³ *SPTL Reporter*, Spring 2000, pp. 2 – 3.

⁴ *SPTL Reporter*, Spring 1999, p. 1.

⁵ *SPTL Reporter*, Spring 1999, p. 2.

⁶ *SPTL Reporter*, Winter 1999, p. 1.

⁷ The comments in the *Reporter's* editorials are, of course, intended to have as their dominant tone hyperbole for good journalistic effect and the editor's extensive academic work in this field, some of which is referred to below, should be carefully distinguished. Similarly, this article should be seen as a “polemic” piece intended to provoke debate and cannot, of course, hope to be an exhaustive treatment of a subject on which much ink has been spilt.

⁸ Many thanks to Ken Brown, Bournemouth University, for his assistance with this point.

⁹ See, for example, Twining, W., *Blackstone's Tower: The English Law School* (London: Sweet & Maxwell, 1994); Bradney, A. and Cownie, F. (eds), *Transformative Visions of Legal Education* (Oxford: Blackwell, 1998); Birks, P., ‘The Academic and the Practitioner’ (1998) 18 *Legal Studies* 397; and Bradney, A., *Conversations, Choices and Chances: The Liberal Law School in the 21st*

Universities UK see the answer in such terms.¹⁰ Of course, I must not ignore one contribution of no less an authority than the Regius Professor of Civil Law at Oxford University, Peter Birks, who posed the question ‘Could we get back to the not so distant days when academics were not permitted to marry?’¹¹ In any event, how much sympathy can be expected from government when even as long ago as 1995/6 over £10 billion was poured into universities?¹² What I wish to do here is to make a contribution from a perspective which will be familiar to many readers, though far from accepted by all – that of a brief law and economics analysis¹³ of two issues: why do we need universities at all and what structures would best suit research and teaching in the 21st Century.¹⁴

The first question might well be ‘why do we need universities at all?’ After all, in the basic economic model universities, their managers and their regulators simply would not exist. Perhaps, neo-classical economic assumptions have never seemed so attractive. The point is that in the world of this model individual academics and students would enter into exchanges with each other with no need for any institutional arrangements at all. Why doesn't the real world resemble this? Let's look at a few of the arguments.

The first is that many universities are there to produce ‘public goods’¹⁵ and that markets are bad at this, thereby necessitating state intervention. Yet this is an increasingly contestable proposition as more and more universities make efforts to ‘capture’ the intellectual property their employees generate and exploit this, for example, by encouraging participation in spin-off companies.¹⁶ It also neglects the historical lesson that university dependence on state funding is relatively recent in origin.¹⁷ And, of course, activities such as teaching need not take place in universities

Century (Oxford: Hart Publishing: forthcoming). For an alternative, non-legal perspective, see Tooley, J. (ed.), *Buckingham at 25, Freeing the Universities from State Control* (IEA, 2001).

¹⁰ ‘£9.94 billion needed for universities’ success’ (Universities UK, 14th June 2002).

¹¹ Birks, P., *op. cit.*, at 406. He is probably right of course. I have three young children and I should know.

¹² The Dearing Report. The figure then amounted to about 1.4% of Gross Domestic Product.

¹³ The writer is deeply indebted to the late Dr Bill Maughan with whom he conducted much research in this area, ideas from which are reflected in a number of places in this article: see, in particular: Copp, S.F. & Maughan, B., ‘Innovative High Growth Companies: The Case Against Special Rules’ (2001) 22 *The Company Lawyer* 234, our last joint publication before Bill's untimely death.

¹⁴ See also Kelsey, J. in Bradney, A. and Cownie, F., *op. cit.*, 51 ‘Privatising the Universities’ who considers the neo-institutional arguments for and against privatisation: I concur with much of her analysis including her rejection of a proposed form of privatisation in New Zealand to convert universities into Crown companies. In this article, I make the case for a far more radical approach to privatisation.

¹⁵ The key characteristics of a ‘public good’ are that it is non-rival in consumption, i.e. with a given level of production, consumption by one person need not diminish the quantity consumed by anyone else, and non-exclusion, i.e. that it is impossible, or prohibitively costly, to confine the benefits once produced to certain persons: see Browning, E.K. and Browning, J.M., *Micro-economic Theory and Applications* (Boston: 1986) p. 596.

¹⁶ See, for example, CVCP Report, ‘Spin-offs and Start-ups in UK Universities’ by Hague, D. and Oakley, K.; HEFCE Report 00/57 ‘The Use of Recommended Practice Guidelines on Related Companies’; and HEFCE Report 01/68 ‘Higher Education – Business Interaction Survey’.

¹⁷ Until the mid-19th Century, universities lived wholly on fees, endowments, donations and the sale of services. Reliance on state funding has been demonstrated to have grown steadily throughout the 1930's until the balance changed dramatically after the Robbins' Report in 1963: see Green, D.G., *Perestroika in the Universities* (London: The IEA Health and Welfare Unit, 1989) pp. vii - ix.

as usually understood.¹⁸ A similar story can be told of research: not a little of the 'black letter' law research turned out by university law schools scarcely breaks new ground; in contrast, visit the web site of almost any of the UK's leading law firms and see the way in which they are forging ahead with innovative development of new 'black letter' law specialisms. More fundamentally the 'public goods' argument only justifies state funding of public goods – there is no inherent reason why such goods should be produced by universities.¹⁹ A related argument to the 'public goods' argument – and one which seems to inspire Universities UK²⁰ – is, in effect, that universities give rise to positive externalities, a sort of nice pollution of the areas they inhabit. But even if that were true – and it has been doubted²¹ – that would be true of pumping millions into almost any regional aid programme (if EC rules permitted this); insofar as the argument is based on foreign earnings then this is, of course, simply an argument in favour of letting market forces operate.

The second is that universities ensure public accountability for the huge sums of money that the state pours into universities. To those familiar with company law, this will seem an odd notion. The governance mechanism in the company is based on accountability to shareholders within the context of a market for corporate control. Despite all the complaints levied against this mechanism there can be little doubt that it is more effective than the role of, say, the board of governors in '1992 universities'.²² The reason for this is simple. Shareholders have a financial interest in their shares; boards of governors have none. However, crude it may seem, money can be a very effective motivator. Indeed, all the signs exist that in universities the principal-agent relationship²³ is giving rise to the classic symptoms of moral hazard and opportunism²⁴, one indicator perhaps being significant increases in vice-chancellor's salaries.²⁵ The usual economic response to this is to argue for the agent's interests to be aligned to the principal's. But how can this be done where the principals themselves have no ownership interest? This is a major structural flaw of 1992 universities. More fundamentally, this argument only justifies controls over fraud and waste which are inherent in many forms of organisation – there is no inherent reason why a university structure is any more effective than others in this regard and some justification for concluding that it is not. Further, the whole basis for

¹⁸ As BPP Law School's existence demonstrates.

¹⁹ Academic freedom might be one such reason: however, one would suspect that that would obtain a hollow laugh from many academics faced with the RAE and a host of other means of state interference in research.

²⁰ *Higher Education Contributes £35 billion to the UK Economy Each Year* (Universities UK, 18 June 2002).

²¹ See Maskell, D., 'The Great Higher Education Investment Swindle' in *Buckingham at 25, Freeing the Universities from State Control*, *op. cit.* who puts it this way '... the arguments for believing in universities as investments are about as strong as those for alien abduction. There's no proof that aliens don't abduct people, and there's no proof that the universities aren't an investment ...' (p. 164).

²² A term used in this article to refer to universities established as higher education corporations under ss. 121, 122 and 129 of the Education Reform Act 1988 and which invariably adopted the title 'university' further to s. 77 of the Further and Higher Education Act 1992.

²³ See Jensen, M. and Meckling, W., 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

²⁴ See Williamson, O.E., *The Mechanisms of Governance* (New York: Oxford University Press, 1996) p. 56.

²⁵ See Goddard, A., 'Hodge Orders Probe Into V-C Pay' *Times Higher Education* 22 February 2002 and Goddard, A., 'V-C's Gravy Train Hits Buffers' *Times Higher Education* 21 June 2002. See also HEFCE's Accounts Direction to HEI's for 2000-01, para e.

a managerial system is the assumption that in team production it is necessary to prevent shirking²⁶ – but where is the evidence to support the notion that in academia there is widespread shirking? Or that the assumptions of team production apply? If one assumes that academics are self-motivated to teach and research out of a love for their subject then there will be no conflict of interest and the whole superstructure of a university should – like a pack of cards – collapse.

The third is that universities achieve economies of scale.²⁷ Quite what these economies of scale are is less clear. The central functions most universities are concerned with are central management functions, finance, personnel management, estates management, marketing and intellectual property. These functions can in turn be classified in three ways: those which are themselves a product of increased size, for example, central management; those which substantially duplicate functions of autonomous or near autonomous schools/departments/centres, for example, finance, marketing; and others which may represent facilities which might otherwise have to be obtained in some other way. Yet it is not enough to examine economies of scale in terms of central functions. Economies of scale relate to the production process of a service and the question must be asked whether universities achieve these throughout that process, including therefore individual schools/departments/centres. The evidence is that they do not. Indeed, reality is more consistent with Niskanen's 'bureaucracy theory'.²⁸ What do bureaucrats maximise? According to Niskanen, their salaries, the size of staff working under them and their salaries, their public reputation, their perks and their power and status. If this theory is correct then, in the absence of a market for corporate control, one would expect university bureaucracies to grow out of control swamping the academic function.²⁹ In terms of law schools, it is hard to see what economic benefits there are to having in the region of 90 universities involved with law provision, each maintaining its own library, teaching (presumably) the same core subjects etc.³⁰ Why then does this sad state of affairs persist? Because market forces are constrained in the university sector. Universities have been prevented at critical periods from true competition through artificial caps on student numbers. Universities are not subject to any market for corporate control. And one might add, hubris: central university functions require a conglomerate structure underneath them to justify their own existence: with specialisation they would not be needed.

²⁶ See Alchian, A. and Demsetz, H., 'Production, Information Costs and Economic Organisation' (1972) 62 *American Economic Review* 777.

²⁷ Technically, the production process for a specific good or service exhibits 'economies of scale' over a range of output when average cost – cost per unit of output – declines over that range. In contrast, where average cost is increasing, then marginal cost must exceed average cost and so production exhibits diseconomies of scale: see Besanko, D., Dranove, D. and Shanley, M., *Economics of Strategy* (New York: John Wiley & Sons, Inc., 1996) p. 174.

²⁸ Niskanen, W.A., *Bureaucracy: Servant or Master?* (London: Institute of Economic Affairs, 1973) or *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971).

²⁹ Let me propose a simple telephone-directory test for swamping: simply take the number of full-time academics who spend less than 50% of their time actually teaching students or researching and divide it by the number of full-time staff in the faculty. If the result is more than 50% consider yourself swamped; even if the figure is more than 25%, given traditional academic apathy towards meetings, you are still likely to be swamped for practical purposes.

³⁰ I would reject any argument based on diversity – generally it is the larger faculties which offer the greatest diversity simply because they can achieve some economies of scale – or based on the benefits of local provision – there are alternative means of resolving access issues, not least decent grants and accommodation.

The fourth is that transaction costs, rather than being zero, as assumed, tend in real life to be high. Such transaction costs stem from uncertainty, frequency, asset specificity³¹ and complexity and lead to various real-life institutions and practices that are designed to reduce contracting costs. Prominent amongst these are the development of various types of economic organisation or firm, markets in information and practices such as advertising and branding, markets in insurance and risk and various legal processes. Universities on this basis are useful as a form of economic firm to reduce the costs of multiple contracting. However, any form of incorporated body will suffice for this purpose, and indeed many 1992 universities are established as common or garden companies limited by guarantee. Other real-life practises, such as the development of league tables, advertising by universities and attempts to create brand images can also be discerned in the university sector. The most pressing issue for universities (even if not usually discussed by reference to the term) is that of asset specificity. Universities, perhaps more than any form of economic organisation are called upon to make investments of this character, in terms of human, physical, site and other dedicated assets. For example, a legal academic encouraged to specialise in the 18th century history of the law of logs and frogs gives rise to asset specificity and this poses problems both for the university and the legal academic. In economic terms this is referred to as 'bilateral dependence'.³² A party considering making such an investment will ordinarily require incentives. To avoid the discussion becoming too broad, the question arises as to what the legal academic requires of an organisation. In a corporate context this would tend to involve more equity participation and lock-in agreements. Academics might regard tenure in a financially sound collegiately governed university a direct equivalent of this³³. But that is no longer on offer.

The fifth, which contradicts the others, is that of path dependency. Since this concept may be less familiar to readers than other economic concepts, I will address it in the text. Path dependency may be defined in the following way:

The increasing returns characteristic of an initial set of institutions that provide disincentives to productive activity will create organisations and interest groups with a stake in the existing constraints. They will shape the polity in their interests ... they provide few rewards from the increases in the stock and dissemination of economically useful knowledge. The subjective mental constructs of the participants will evolve an ideology that not only rationalises the society's structure but accounts for its poor performance. As a result the economy will evolve policies that reinforce the existing incentives and organisations.³⁴

³¹ Asset specificity can be defined as 'A specialised investment that cannot be deployed to alternative uses or by alternative users except at a loss of productive value. Asset specificity can take several forms, of which human, physical, site and dedicated assets are the most common': see Williamson, O.E., *op. cit.*, at 377.

³² Williamson, O.E., *op. cit.* at 106 – 109.

³³ From an economic perspective the downside of bilateral dependence is that bilaterally dependent parties cannot respond quickly and easily so maladaptation costs are incurred: see Williamson, *op. cit.*, at 106 – 107.

³⁴ North, D.C., *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990) p. 99.

Sounds familiar? Universities exist as they do because they have existed that way from the beginning – in some cases perhaps for centuries - and a whole army of people exist with reasons to preserve universities that way. They can be seen rolled out at any university's ceremonial functions. Few universities, it seems, are too proud to have another failed politician somewhere on their books and the political elite like it that way. But from an economic perspective it's simply inefficient. Better perhaps Schumpeter's theory of creative destruction.³⁵

The second question that naturally follows is 'what structures would best suit research and teaching in the 21st Century?' I would suggest we move towards the following. University central functions/schools/ departments/research centres should be converted into limited liability companies; shares in the central functions of the university should be owned by the schools/departments/research centres; shares in the schools/departments/research centres should be owned by their academic employees. Where schools/departments/research centres believed they were getting value for money from the central functions company they would retain its services, otherwise they would be free under ordinary company law principles to change its management or contract elsewhere. Where schools/departments/research centres saw advantages in co-operating with others they could continue to do so (possibly on the basis of freely entered long-term contracts). Otherwise, they could team up with others elsewhere in the country. No doubt the reader will recognise immediately that this proposal spells the effective end of universities as we know them. Since on this basis, funding for research and teaching should where possible follow academics and students rather than institutions, there would be no reason why any group of academics could not simply band together and form their own educational company in a free market and could choose whether to take higher education bureaucracy with them. Yet this, it is submitted, would unleash a ferocious new academic energy unbridled by the frameworks of state interference. There would be winners and losers – a process of creative destruction – and we would see some institutions disappear. But we would also see new forms of collaboration emerge.

Of course, the arguments which I have put forward simply address the lack of an economic justification for universities. They are accordingly based on placing a single value – economic efficiency – at the apex of human priorities. Against this many in higher education will argue that other values should be pre-eminent.³⁶ Broadly, these alternative values can be summed up under the umbrella term of a liberal education. They encompass such notions as the value of knowledge for its own sake rather than as a matter of utility, the linked notion of academic freedom and the value of collegiality, embracing notions of structure, cross-fertilisation of knowledge and cross-subsidy of money. Some would commit the solecism of arguing for state interference on the basis of market failure – thus recognising the importance of efficiency in the allocation of goods and services. How can I argue against these nostalgic visions of higher education: after all, I enjoyed revising for my undergraduate examinations lying in the greenery of Exeter Cathedral's grounds as part of a Law School that would no doubt have satisfied the aspirations of those arguing for a liberal education, propped up by a student grant kind enough to keep me in all student conveniences. How could I dare to seek to deny this to future

³⁵ Schumpeter, J., *Capitalism, Socialism, and Democracy* (New York: Harper & Row, 1942).

³⁶ I am indebted to the Editor for reminding me of these very important issues.

generations? The simple answer is that, like most nostalgic visions, it no longer holds true. There are no more tenured academics permitted like a thousand flowers to bloom; academic freedom for most is an opportunity to write some stultifyingly dull piece of work to satisfy the RAE assessors; collegiality dies the moment there are redundancies in higher education; inevitably there is a 'we' making 'them' redundant; I am less convinced as to the role of cross-fertilisation given the omnipresence of conferences; and cross-subsidy of money would seem unlikely to gatecrash many universities' administrative systems. The liberal vision of higher education is dying on its feet, strangled by state control and Soviet-style structures. Since freedom must be at the heart of liberal educational values then free markets must be more consistent with its development than the state, which is simply an organisation, as North nicely put it, 'with a comparative advantage in violence'³⁷.

In conclusion, my proposals would involve change as dramatic as the dissolution of the monasteries – institutions which provide a fascinating historical parallel – however, the potential benefits are enormous. Universities exist in a competitive global economy. They may react, to use Porter's generic strategies³⁸, either by trying to gain some cost advantage over their rivals or by seeking to differentiate their products. The challenge of these proposals is that they would achieve both and give the UK a comparative advantage in the substance if not the shell of higher education that would boost the economy and benefit students and academics. Whilst one would obviously shed a tear for the fate of university chancellors, vice-chancellors, boards of governors, bureaucrats and others, that tear may just be worth shedding in the interests of economic efficiency.

*Stephen Copp*³⁹

[* This version reflects the text of the article as published in (2002) 25 Society of Legal Scholars Reporter 29 – 33 but is not a facsimile copy of it.]

³⁷ North, D.C. *Structure and Change in Economic History* (New York: W.W. Norton & Co., 1981), p. 21.

³⁸ Porter, M., *The Competitive Advantage of Nations* (Basingstoke: Macmillan, 1990).

³⁹ Bournemouth University. I would like to thank the Editor, Tony Bradney of Leicester University, for his comments on an earlier draft of this article. The usual disclaimer applies. The law is stated as of 7 July 2002.