

CHAPTER 2

THE PUBLIC-PRIVATE DIVISION OF RESPONSIBILITY FOR EDUCATION*

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Abstract

In this chapter "private" schools are defined as those that were privately founded and are privately managed; they usually have some private funding, although in some cases considerable funding and control come from the government. The size and nature of the private sector is viewed as stemming from excess demand for education due to limited public spending (i.e., these are students who would prefer to use the public schools but are involuntarily excluded and pushed into the private sector); differentiated demand due primarily to cultural heterogeneity (i.e., these are students whose differentiated tastes along religious, linguistic or ethnic lines lead them voluntarily to choose the private sector even if a public school place is available); and the supply of non-profit educational entrepreneurship (e.g., founders who start schools to maximize religious faith or believers, rather than profits) by competing religious organizations. The impact of public policies, including public educational spending and private subsidies, is also considered.

Introduction

Education yields both private benefits to the student and public benefits to society at large. As a result, it can be financed through the public or private sectors. Even when government funding predominates, management can be carried out through the public hierarchy or through private groups, as when schools founded and operated by non-governmental organizations are subsidized. Thus, a wide range is observed in the public-private division of funding, management and enrollments.

What factors account for these differences across societies? How does the process of economic development affect the public-private division of responsibility for education? This chapter investigates these closely related questions. The answers are important because private schools behave differently from public schools, a system that is largely private may provide a different educational service from one that is largely public, and the underlying *raison d'être* for the private sector helps to explain these differences.

Before beginning the discussion it is necessary to define what is meant by "private." This is by no means clear-cut in situations where many "private" schools are heavily funded and regulated by the state. In most developing countries, private schools depend mainly on private funding, but in many developed countries subsidies cover a large proportion of total expenses, and government control over hiring and firing of teachers and student admissions criteria accompany these subsidies. "Source of funding" and "degree of decision-making authority" then yield different public-private categories and many mixed rather than polar cases (see Cummings & Riddell, 1994, and James, 1991a for further discussion of this point). In this chapter

* This is a slightly revised version of a paper that will appear in the *International Encyclopedia of Education*, Second Edition, Oxford: Elsevier Science Ltd, 1994.

“private” schools are defined as those that were privately founded and are privately managed; they usually have some private funding, although considerable funding and control may also come from the government. The first section presents a model used to analyze the role of the private sector in many countries and the second section presents supporting empirical evidence.

Determinants of Private Sector Size and Other Characteristics

The private share of total enrollments at the primary and secondary levels covers the entire spectrum, from 1 to 100%, and the variation is almost as wide at the higher educational level. Upon examination of these data, two observations stand out: (1) at the secondary level the relative size of the private sector is much larger in developing than in developed countries, and (2) within a given level of education and stage of development there is a large, seemingly random, variation.

How do we explain these two observations? This section sets forth a conceptual framework for answering this question. (For details about this model see James, 1986a, 1987, 1993.) The first observation is attributed to limited public spending, which creates an “excess demand” from people who would prefer to use the public schools but are involuntarily excluded and pushed into the private sector. The second observation is attributed to differentiated demand stemming from cultural (religious, linguistic) heterogeneity or differentiated tastes about quality which lead people voluntarily to opt out of the public system to secure the kind of education they prefer. In both cases, the supply of non-profit entrepreneurship, much of it by diverse religious organizations in their competition for a larger market share of “souls”, is hypothesized to play an important role in determining private sector size and other characteristics.

Excess Demand

Suppose that, through some collective choice process, each country decides how much and what kind of public education to provide. (See below for determinants of this choice.) Each family then has three options: to attend a public school if available, to attend a private school, or not to attend any school at all. The private sector can be thought of as a market response to situations where a public school place is not available for everyone or where some people are dissatisfied with the type of government schools provided, and where other people are willing to supply alternative schools, often for non-pecuniary reasons. Two very different patterns of private education have evolved around the world, depending on whether the motivation is excess demand or differentiated demand.

Excess demand for education often exists when the capacity of the public school system is less than full enrollment; that is, the option of attending a free or low-price public school is not available to everyone. If the private benefits from education are high (e.g., because of labor market rewards), many people who are left out of the public schools will seek places in private schools, as a “second best” solution.

The “excess demand” model most clearly applies to education in Western countries in the nineteenth century and to many developing countries today. Examples are Kenya and Indonesia where, until recently, the majority of secondary school enrollments were private, and Brazil and the Philippines, where the majority of college enrollments are private. Among industrialized countries currently, Japan best fits the “excess demand” model; over three quarters of higher education students attend private institutions, mainly because of limited space in the preferred public universities (see; Levy, 1986a; Winkler, 1990, James, 1986a,b, 1991b; James & Benjamin, 1988).

In these situations, a political coalition of groups with high tax rates and low benefits from education has limited the supply of government schools, especially at the secondary and higher levels. At the same time, because of the large private benefits to education, many families are anxious to send their children to school, even if they must pay themselves. Under these circumstances, the smaller the capacity of the public sector is relative to the size of the age cohort, the larger will be the excess demand for the private sector.

A number of predictions follow about the characteristics of excess-demand-driven private sectors. Since the basic cause is postulated to be limited government spending, excess-demand-driven privately managed schools are also likely to be privately funded. In order to attract low and middle income students and because of competitive pressures, many of these schools will keep their fees low e.g., lower than costs per student in public schools. This in turn means that their expenditures per student must be low. If the limited spaces in public schools are rationed by academic criteria, the private sector will cater to students

with lower incoming qualifications than public schools, and will therefore also have lower outgoing results. Since academic performance is highly correlated with socio-economic status, the income bias in the private sector (due to price barriers) may be no greater than that in the public sector (due to academic barriers). Excess-demand-driven private schools may be considered less desirable than public schools, but they will still be utilized by students who cannot get into the latter.

At the higher education level some additional predictions may be made about the product mix that will be chosen by excess-demand-driven private universities. Since families are more likely to pay for products with private rather than social benefits, undergraduate teaching will be stressed over graduate training and research. For similar reasons, low-cost vocational fields will be emphasized, e.g., business management and law rather than laboratory science.

Differentiated Demand

Excess demand cannot be the motivation for private schools in advanced industrial societies which guarantee a place for everyone in their public schools. The alternative explanation, differentiated demand, views private schooling as a response to differentiated tastes about the kind of education to be consumed. This model hypothesizes that important taste differences about education stem from religious and linguistic differences that concern group identification. Then, the greater the cultural diversity of the population and the more uniform the public educational system, the larger will be the differentiated demand for private education. If cultural minorities have sufficient political power, they may obtain subsidies for their schools, which further increase private sector size (see below).

Private sectors driven by differentiated tastes exist both in developing and developed countries. For example, the "melting pot theory" and a general belief in assimilation of minorities led to the "common school" movement in the nineteenth and twentieth century U.S.; but the growth of Catholic private schools was a response by a group that did not want to be fully assimilated. In India, too, many private schools and colleges accommodate religious or linguistic minorities such as Muslims, Parsees or Sikhs. The same is true of the Chinese and Indian minorities in Malaysia. However, the best example of the "cultural heterogeneity" model is the Netherlands, where two-thirds of the population attend privately managed, publicly funded schools, a response to the pervasive religious cleavage which dominated that country at the turn of the century (see James, 1984, 1989).

Since a public school alternative is available, consumers who choose differentiated private schools (in contrast with those who attend excess-demand-driven private schools) must feel these are "better" along some dimension. For cultural minorities the relevant dimension may be related to socialization, ideology, or value-formation, rather than cognition. However, differential preferences about academic quality can also lead to the development of private schools; a low-quality public sector school may stimulate the growth of a high-quality private sector school, meeting the demand of those willing and able to pay for academic quality. This might be the case, for example, if political pressures led public quantity to expand by taking in more students, without a commensurate increase in educational spending. The phenomenon of private schools differentiated from public along academic quality lines has been observed at the secondary level in the U.S., and the U.K., India, the Philippines and Brazil, and at the university level in many Latin American countries. Since demand for academic quality is highly income elastic, for any given public quality the academic quality-driven private sector is expected to be larger in areas with greater income inequality, especially those with more families in the upper tail of the income distribution.

Non-Profit Supply

While the size and nature of the private sector in a society is thus partially determined by the source of demand, supply forces also play a crucial role. Private schools are often established as non-profit organizations, i.e., as organizations that cannot distribute a monetary dividend. Indeed, non-profit status is legally required for educational institutions in many countries.

Therefore, one cannot be sure that private schools will spring up wherever a pecuniary profit exists, since non-profit capital and entrepreneurship may not be available. On the other hand, non-profit schools may spring up in situations where for-profits could not break even, because of their lower cost functions due to donated capital, volunteer labor, and tax advantages. The availability of non-profit entrepreneurs, therefore,

may strongly influence the growth of the private education sector. It is necessary to ask: what are the motives of people who start non-profit schools, and what factors determine their availability?

An answer to this question is suggested by the observation that most founders of private schools (and other non-profits organizations) are “ideological” organizations — political groups, socialist labor unions and, first and foremost, religious groups. Examples are sectarian schools in the U.S. and U.K., Catholic schools in France and Latin America, Calvinist schools in Holland, ultra-orthodox Jewish schools in Israel, missionary activities in developing countries, services provided by Muslim waqfs (religious trusts) in the Middle East, etc. Usually these are proselytizing religions, using schools as a mechanism for shaping values, socializing old members, and attracting new ones. And competing ideologies have often been forced to start their own schools, as a defensive strategy (e.g., the “independence schools” in Africa and the caste-dominated schools in India were started partly to keep their members out of the Western-dominated Christian schools). This model hypothesizes that these non-profit founders concentrated on education because schools are one of the most important institutions of taste formation and socialization. It follows that the private educational sector will be larger in countries with many strong, independent religious organizations competing for members and member loyalty, through their schools, historically, or currently. Non-profit theory further predicts that non-profit schools will tend to be higher in quality than for-profit schools, but their relative standing *vis à vis* public schools is *a priori* ambiguous. (For a fuller discussion of the motivations and behavior of non-profit organizations see James, 1983, 1989; James & Rose-Ackerman, 1986.)

Government Policies

Finally, government policies influence the demand for and supply of private schools. As mentioned above, excess demand and differentiated demand for private education depend critically on the size and nature of the public school system, as determined in part by public educational spending. A second type of policy concerns government regulation of private schools, which may increase their costs and decrease their availability. In extreme cases, private schools have been virtually prohibited; this was the case, for example, with respect to Catholic schools in eighteenth century England and Holland and private schools in Pakistan and Tanzania during the 1970s. A final important policy concerns the provision of public subsidies to private schools, which increases the total effective demand that they face. Most advanced industrial states heavily subsidize their private schools and this is probably one reason why private education has not disappeared as free public schools have become available.

Empirical Data

The various hypotheses set forth above — that the private educational sector will be large where public educational spending is small, where differentiated demand for quality, cultural heterogeneity and religious competition are great, and where government subsidizes private schools — have been tested statistically at the primary and secondary educational levels and consistent results have been obtained.

Interstate Comparisons

For example, these demand and supply side forces have explained differences in private sector size across states or provinces in the Netherlands, India, Japan, and the U.S. (James, 1986a, 1987). In all these cases, a “religious competition” variable was included and proved to be highly significant. In the United States the private sector is relatively large in states where per capita income is high, public expenditures per student are low, and the proportion of Catholics and Blacks are high, consistent with the differentiated demand and non-profit entrepreneurship theories of private school formation. In the Netherlands the proportion of Catholics plus Calvinists in the province proved to be the most important variable. In Japan and India the presence of early Christian missionaries was central. In Brazil, where public spending on secondary education is low, the private sector is quality-driven and many for-profit schools exist, interstate differences in income inequality are the most significant explanatory variable (James, Braga, & Andre, 1990).

Cross-Country Comparisons

These hypotheses were also tested across a sample of 50 countries, using OLS, logit, and 2SLS (James, 1993). Once again, the most consistently important factor explaining the relative size of the private sector was cultural heterogeneity, particularly religious heterogeneity, which combines both demand and supply side effects. Linguistic heterogeneity, too, had a positive, although somewhat weaker effect. Income diversity, on the other hand, was insignificant (possibly because public school quality was not controlled). Taken as a group, the heterogeneity variables explained 25% of the variance in private enrollments.

These findings have important implications for the behavior of private schools. For example, they suggest that private schools often segment the population along religious, linguistic, nationality, or ideological lines, because of the motivations of their non-profit producers and differentiated consumers. Many countries, particularly those trying to build a sense of national unity out of disparate groups, may fear these divisions.

While basic cultural factors play a large role, public policies are also crucial. Thus, the presence of "large" subsidies to the private sector (i.e., subsidies that cover more than 70% of total expenses) increases the private enrollment share 10 percentage points. In contrast, public educational expenditures have a strong negative effect on private enrollments. Once this variable is taken into account, the difference between developed and developing countries in relative private sector size disappears; i.e., low public educational spending at the secondary level in developing countries "explains" the large excess demand there. This suggests that if developing countries increase their public spending, some private schools will be crowded out, so total enrollments may not rise as fast as spending or as much as was anticipated.

This result holds whether public spending is treated as exogenous or as endogenous, simultaneously determined with private sector size. The key variables that explain public spending in the simultaneous model are per capita income, non-educational governmental spending, an index of political and civil rights, and proportion of the population aged 0-14. The first three have a positive effect; the latter has a positive effect on primary spending but not on secondary spending, evidence of the quantity-quality trade-off in family size decisions. Private sector size does not seem to influence public educational spending, although the converse is clearly true.

Evidence on Characteristics of Private Sectors

The empirical evidence on characteristics of excess-demand-driven private sectors is consistent with the predictions made above. For example, studies of non-governmental secondary schools in Japan and Kenya (1960s and 1970s) and Tanzania (1980s) indicate they are (or were) largely funded by private fees and spend much less per student than public schools (see James, 1986a; James & Benjamin, 1988; Samoff, 1991). Cost economies are achieved by offering large classes, using meager supplies and equipment, and paying teachers low salaries. Their ability to function with lower costs has been variously attributed to lower quality, greater efficiency, selection of more motivated students, or reduced power of teachers to obtain rents. Even controlling for examination scores, schools with a large share of funding from private sources seem to incur lower costs per student, evidence of greater efficiency. (See Jimenez & Paqueo, 1993, but a quadratic U-shaped relationship is found in James, King & Suryadi, 1993.)

To a lesser extent, differentiated-demand-driven private sectors also exhibit these scale economies. Most analyses of test scores have indicated higher value added in private schools, even after controlling for socio-economic background of students, but it is unclear how much of this is due to their quality and how much to their selection of motivated students on peer group effects. Religious non-profit schools appear to be higher in cost and quality than for-profit. (For developed countries, see Coleman, Hoffer, & Kilgore, 1982; Coleman & Hoffer, 1987; critique summarized in Haertel, James, & Levin, 1986; James, 1991c. For developing countries see Jimenez, Lockheed, & Wattanawaha, 1988; Jimenez, Lockheed, & Paques, 1991; Jimenez, Lockheed, Luna, & Paque, 1991; Jimenez & Lockheed, 1995.)

A similar picture concerning revenues, costs, and student ability holds for excess-demand-driven universities in Brazil, the Philippines, and Japan (see Levy, 1986a; Winkler, 1990; James, 1991b; James & Benjamin, 1987, 1988). As expected, these universities concentrate on undergraduate teaching of low-cost vocationally oriented fields such as law, management, and economics. (In contrast, public universities in these countries and elite private universities in other countries place greater emphasis on graduate education, research and science, financed largely by public funds.) The socio-economic distribution of their student body is income-biased, but not more so than in the more selective public universities.

Impact of Large Subsidies and Regulations

Another study investigates in greater detail the impact of large subsidies on the size and characteristics of the private sector in a sample of 35 countries (James, 1991a). It turns out that this relationship is quite complex. First of all, the majority of countries in the overall sample provide little or no subsidies. However, if we disaggregate between developing and developed countries, the picture changes; most of the latter provide large subsidies (covering more than 70% of total expenses) to their private primary and secondary schools, while most of the former provide only small subsidies. Empirically, it seems that private schools depend mainly on fee financing in the early stages of development, while government funding displaces private funding later on.

Second, at the secondary level many developing countries have "large" private sectors (i.e., above the median in Table 1.1), even though they offer little or no subsidies. In contrast, all developed societies with large private sectors have large subsidies. Thus, subsidies appear to be a necessary condition for the growth of large private sectors in modern industrial states, while large fee-financed private sectors seem viable in developing countries. This is consistent with the hypothesis that excess demand is driving private education in many developing countries, while differentiated demand is the driving force in developed countries; people are more willing to pay fees for the former than the latter.

Finally, it should be noted that substantial regulations usually accompany large subsidies. These regulations are similar to those applied to public schools; typically they specify hiring and firing procedures, credentials and salaries of teachers, criteria for selecting students, price and expenditures per student, and participants in the school's decision-making structure. In particular, they raise salaries and other costs while lowering private price and contributions (see James, 1984, 1991a,c). This is the origin of the public-private hybrid mentioned at the beginning of this chapter. Large private sectors in developed countries are heavily subsidized, heavily controlled and, in fact, these forces lead them to behave very much like the public sector.

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