

Research into the Economic Principles Underpinning the Education Export Levy

The Education New Zealand Board recently commissioned the economics consultancy, Charles River Associates, to produce a thinkpiece on the following:

- a clear analysis of the circumstances in which levy funding of an industry is supported by economic analysis;
- an analysis of the different types of activities funded by the Education Export Levy and relate these to the economic analysis of the rationale for levy fund;
- an analysis of the type and scope of activities that will maximise the industry good for New Zealand's education exporters (conferring benefits on all institutions in the industry); and
- consider whether (and if so, how) an industry levy assists in the attainment of the New Zealand Government's long-term goal of increasing self management by the industry over time (within the baselines of Government regulation).

A summary of the findings of the Charles River Associates research is outlined below.

Review of Other Industry Levies

- Compulsory levies have a long history in New Zealand agriculture.
- The Commodities Levies Act 1990 now applies, with the key rationale being that industry activities may be subject to a free rider problem.
- Under the CLA, farmers vote every six years on the levy and its uses.
- Levies are used in the meat, wool, dairy and deer industries for:
 - Product and market R&D
 - Generic industry promotion
 - Plant and animal health
 - Quality assurance
 - Education, information provision and training
- 28 Regional Tourism Organisations are also funded by targeted rates/industry levies with the key rationale that levy-funding mitigates free rider behaviour.
- The RTO levies are used for:
 - R&D
 - Branding and promotion
 - Strategic planning
 - Management of Visitor Information Network centres
 - Support for regional conference venues and services
 - Regional event promotion and development

Economic Principles underpinning Industry Levies

- At a broad level: (i) the rationale for the agriculture and tourism levies is similar; and (ii) the uses of the funds are similar.
- In all cases there are numerous beneficiaries.
- The degree of homogeneity between payers varies.
- Even if there is a market failure due to free rider behaviour, it is not axiomatic that central intervention or compulsion is justified. This is because the industry may be able to coordinate itself to voluntarily solve the free rider problem.

- The ability of an industry to do this will be a function of the transaction costs involved. These will be higher: (i) the greater the number of participants involved; and (ii) the more heterogeneous their interests.
- In the case of Export Education, there are a large number of industry participants with very heterogeneous interests. Therefore, voluntarily coordinating to solve free rider problem is not an option.

The Education Export Levy

- Research: it is clearly established that free riding is an issue in respect of industry research. The research paper concludes that there is a strong argument for the Education Export Levy funding industry research.
- Generic Marketing: there is a strong degree of free rider behaviour present in generic promotion of homogeneous products. Where there are high information asymmetries, CRA argues that the free rider problem in generic promotion would also be strong in more heterogeneous industries, such as export education in terms of generic information about New Zealand. The research paper concludes that there is a strong argument for the Education Export Levy funding generic promotion.
- Quality Assurance: there is some free riding in the development of standards. However, information asymmetries and reputational externalities are also important with quality decisions impacting on others within the industry. The research paper concludes that there is a strong argument for the Education Export Levy funding quality assurance.
- Professional Development: the benefits of on-the-job training cannot be completely appropriated by the firm. Nevertheless: (i) firms have strong incentives to invest in their own staff; and (ii) there does not appear to be anything special about professional development within the export education sector. The research paper concludes that there is no free rider problem in the area of professional development.
- Industry Self Determination/Management: the research paper concludes that with Education New Zealand managing the allocation of funds from the Levy in a open and accountable way, the compulsory export education levy is assisting in attaining the objective of greater industry self determination/self management. However, it recommends that Education New Zealand puts significant effort into demonstrating the value of the products and services funded through the Levy to the payers of the collective funding.

Education New Zealand's Position on the Education Export Levy

The Education New Zealand Board has discussed the above research findings and formally signed-off on the following position regarding the Education Export Levy:

- Education New Zealand agrees that the potential for free rider behaviour exists in certain areas within the education export industry. As a result of the large number of industry participants with very heterogeneous interests, voluntarily coordinating to solve free rider problems is not an option. On this basis, Education New Zealand supports the Levy for funding certain types of activities (see next two bullet points).

- Education New Zealand fully supports the Levy being used to fund industry good research, generic marketing and quality assurance via a consultative process that is managed by the industry itself.
- Education New Zealand reflects mixed support for the Levy being used to fund professional development. Our recommendation is that perhaps the best way forward is to allocate a strictly limited sum for professional development, with the balance diverted into research and generic marketing.
- Education New Zealand believes that the Levy is a key mechanism for the industry to exercise greater self determination/management, and recommends that it is retained.
- In the medium term, our vision is to move progressively towards having the Levy as a non-compulsory mechanism that can be levied across the entire industry following a vote by payers (in the same way as various other levies under the Commodities Levies Act). In this regard, Education New Zealand requests that the Government should work with Education New Zealand to set a path to further devolve responsibility for industry development to Education New Zealand.