Preface

BACKGROUND

In the late 1990s Guillermo Perry, then World Bank Chief Economist for Latin America, addressed a group of educators assembled at the World Bank Institute and remarked upon the great need to know more about 'the political economy of education'. He went on to explain that this meant learning how the 'power of market forces' could be brought to bear in the education sector in order to promote greater efficiency and better performance in the same way competition improves private sector organizations. Other social sectors such as health, said Perry, have made successful efforts to introduce market forces into areas previously considered the realm of the public sector. Why have there not been more such efforts in education?

With a doctorate in ‘Political Economy and Government’ and most of my professional life spent working to improve education in developing and developed countries, I took Perry’s call for more knowledge about the political economy of education as a special challenge. The argument was familiar, as were both the examples from health and the difficulty of introducing market forces in education to which he referred. That marked the beginning of what has been a multi-year effort to understand the role of market forces in education, to examine whether other interventions and approaches to providing incentives to improve education have been successful or not, and why.

My early attempts to gather information revealed that the overwhelming majority of publications relating to the 'political economy of education' and introducing market-like forces into education concerned either (a) providing monetary rewards to improve teachers’ performance, or (b) introducing competition through vouchers or other approaches to providing ‘school choice’. This gave rise to the categorization of approaches to providing incentives used in this book. ‘Rewards’ include merit pay to individual teachers and merit awards to whole schools rather than to individual teachers, as well as changes in the traditional system of teacher compensation under which all teachers with the same experience and levels of education receive equal pay.

‘Competition’ includes all the forms of educational choice that have been the subject of intense study and debate throughout the 1990s and on into the present century. Milton Friedman’s idea of providing vouchers so parents can
Incentives to improve education

send their children to schools of their choice is the main theme in this category of approaches to providing incentives. Vouchers enable parents to send their children to private schools – whether existing schools (church-sponsored or others) or newly started private initiatives – thus providing competition. Charter schools, which are financed with public funds but operated by individuals or groups with a vision of education that differs from traditional public schools, constitute another important subcategory. There are still other approaches to offering parents alternatives or choices among different forms of education that compete with the traditional schools and, in theory, bring about improvements in performance in both new and traditional schools. These include within-district choice, magnet schools, pilot schools and similar ways of offering choices between alternatives.

Often linked with these two categories of incentives is a third approach to improving educational performance: introducing external standards and making schools accountable for their performance. Standards based upon standardized tests provide the information parents need in order to exercise choice. By identifying which schools do the best job of educating children, standards inform authorities about how well schools are meeting their objectives, and may provide the basis for either rewards (whether positive rewards to teachers and schools or flows of enrollment to the schools with better results) or sanctions that can include closing a school that is performing poorly. While standards are not in themselves a market-like mechanism, they are linked to both rewards and competition by providing the information that enables markets to function. I call this category of incentives ‘threats’. To the best of my knowledge, this three-way categorization of incentive systems has not been used before.

NEW INSTITUTIONAL ECONOMICS AND INCENTIVES TO IMPROVE EDUCATION

A parallel interest in New Institutional Economics (NIE), especially the work of Douglass C. North and Oliver Williamson, intersected with my interest in incentives in the education sector. The best-known work on NIE has focused on the theory of the firm, the role of transaction costs in influencing how economic activity is organized, and the importance of ‘institutions’ – what North calls ‘the rules of the game’ – in determining economic performance. Virtually all of this work has looked at firms, institutions and performance at a macro level; at national economies or at least large subdivisions thereof. But institutions exist at a more micro level as well.

Institutions as North defines them include formal rules, informal rules and enforcement mechanisms. The term ‘institutions’ has several meanings in Eng-
lish. In the most common usage it means ‘things’ like universities, hospitals, banks and other entities that NIE calls ‘organizations’. But the term is also used to refer to the broad complexes of rules and norms that govern the behavior of individuals, organizations and firms. These include legal, political and regulatory systems, the policing mechanisms for enforcing laws, financial and insurance systems, a free press, the market system and all the rules and formal and informal enforcement mechanisms that operate within it.

The well-known phrase ‘the institution of marriage’ is a good example of this broad use of the term institution. Marriage is in some ways a legal contract with important financial implications, yet it also has powerful roots in religion and culture, and prevailing social norms and mores (about fidelity, for example) play a huge role in shaping and sustaining the institution. Society supports and enforces the rules surrounding matrimony, whether in courts, by providing ‘marital deductions’ in income tax, through the Church or through the strong influences of family, friends and society as a whole.

Do institutions exist at the extreme micro level, within schools? At a panel discussion at which Douglass North, Oliver Williamson and others were considering the distinction between organizations and institutions, I once asked whether institutions can exist within organizations. ‘Absolutely’, replied Williamson without hesitation. Yet there has been relatively little study at this extreme micro level. NIE examines economic factors at a more micro level than the mainstream theory of the firm, looking at factors that determine whether economic activity is organized through atomistic markets or into firms, but little work has been done on the institutions that operate within organizations. (Exceptions, such as Jensen and Meckling’s work on organizational strategy, are found in the management literature.)

If institutions can exist within organizations (including schools) – that is, if formal and informal rules and enforcement mechanisms have an influence on performance at this extreme micro level – this implies that the body of knowledge we have about how institutions work can be applied to understand education better. Institutions influence performance by providing the confidence, stability and sense of security that enable economic actors to go ahead and engage in buying and selling, to enter into contracts and to take the risk that other parties will uphold their end of the bargain. Does the institutional environment within a school have the same sort of influence on the behavior of teachers, students and other actors that institutions have at a national level? Do within-school institutions reduce uncertainty and encourage actors to make commitments? If so, how does this affect how well schools produce learning? And what are the effects of interventions designed to provide incentives to good performance on institutions within schools?

These are the questions on which this book focuses. The first chapter develops a set of concepts that, taken together, constitute a model of how
Incentives to improve education

Institutions function inside school organizations. A small empirical study described in Chapter 2 examines whether it is feasible to measure institutions within schools and whether there is an association between a school’s institutional environment and its performance. Chapters 3 through 5 consider each of the categories of incentives identified above and how they relate to institutions within schools. A final chapter draws together conclusions and implications.