

Caveats for the New Localism in Further Education - Why the use of Principal-Agent solutions at the local level will not work

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Abstract

The post-incorporation Further Education (FE) sector has experienced a number of quasi-markets over the past twenty three years designed to incentivise college agents (managers and lecturers) to meet government objectives. To create such quasi-markets Principal-Agent (P-A) solutions have been introduced in the form of a series of funding incentives and inspection frameworks under the Conservative administration (1993- 1997), New Labour (1997-2010), the Coalition government (2010-2015) and currently under the new Conservative administration. This paper reviews the FE literature to assess the effectiveness of these P-A solutions as a means of improving students' skills for employability, needs-based equity for disadvantaged students and the wider benefits of education. The conclusion is that such P-A solutions have been ineffective at realising these goals because distant government diktats are unable to accommodate local knowledge of communities and businesses, leading to the creation of incomplete contracts which limit professional values, intrinsic motivation and tacit knowledge in the production process. Centralised funding incentives and inspection frameworks have also led to gaming behaviours and impression management activity as a means of presenting colleges as auditable commodities. More particularly, P-A solutions have encouraged a performative culture where students are viewed as commodities (of financial and presentational value) to the detriment of both needs-based equity for disadvantaged learners and student employability. Significant caveats are provided in this paper for the current Conservative government to consider in its planned policy of improving skills for employability through localism and devolution in the FE sector. It suggests that if single-minded P-A solutions are used at the local level, through the continued use of funding and inspection targets and incentives, they will not improve skills for employability or needs-based equity for disadvantaged students, nor will they facilitate a regard for the wider benefits of education due to the creation of incomplete contracts. New forms of local governance and accountability will be required to facilitate more flexible Principal-Agent relations which accommodate decision-making, intrinsic motivation and professional values at the local level.

Key words: Localism, Funding, Inspection, Further Education, Professionalism, Gaming

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Introduction

Orthodox economics assumes a genus of man called *homo economicus* or economic man. Such a man is essentially motivated by money (or material wealth). The policy prescription, if we assume self-interested behaviour and exogenous motivation, is given in the economics literature as one based on Principal-Agent (P-A) theory (or Agency Theory) in which asymmetry of information (in terms of cost, quality and effort) is addressed through incentive contracts provided by the principal, leading to the agent increasing effort and revealing previously concealed information (Dixit 1999). Government policy from the Incorporation of colleges in 1993 onwards has been predicated on the orthodox P-A assumption of self-interested, utility-maximising agents (i.e. college managers and lecturers) requiring incentives to direct them towards government objectives. In particular, the incorporation of colleges (the outcome of the 1992 Higher and Further Education Act) led to a shift from monopolistic state provision to a quasi-market in which it was assumed funding and inspection incentives would direct self-interested college agents (managers and lecturers) towards government objectives (Le Grand 1993; Le Grand and Bartlett 1993). Within this context, a new form of governance, what Ball refers to as ‘controlled decontrol’ (Ball 2008 41), in which steering from the centre, through contracts and targets, rather than rowing (through traditional bureaucracies), became the norm.

In this article the post-incorporation FE literature is reviewed to assess the extent to which the policy of funding and inspection incentives, predicated on P-A theory, has been effective, and to consider its likely effectiveness as a policy tool within the Conservative administration’s current plans for increased localism and devolution within the FE sector.

The main goal of economic models such as P-A theory is to improve efficiency (i.e. to improve the relationship between education inputs and outputs). More specifically, increased technical efficiency would involve an improvement in education outputs (in particular government objectives such as improving skills for employability) for a given level of inputs, whilst an increase in price efficiency would involve a reduction in unit costs, for a given level of output (Monk 1990).

In analysing the impact of P-A solutions on FE Colleges this paper also has a concern for the extent to which colleges, in responding to government diktats and targets, also have a regard for the wider benefits of education and thus the needs of society (what economists refer to as exchange efficiency). To what extent has a desire to achieve government objectives led college lecturers to ‘teach to the test’ or focus resources on achieving PIs and targets in FE, at the expense of the wider benefits of education? Such benefits (externalities or ‘spillover effects’ in economics, so called because they spill over to the broader society) have a positive impact on exchange efficiency and relate to cultural benefits external to the consumer such as citizenship, social cohesion and political awareness (Psacharopoulos and Woodhall 1991).

A final concern relates to the impact of P-A solutions on equity in the FE Sector. Equity is essentially concerned with what represents the ‘most fair’ distribution of what is produced. There are a number of possible value laden approaches to what is equitable provision but the focus of this article is on needs-based equity which may be defined as an:

... egalitarian approach to social and educational inclusion which aims to focus funding on the most marginal groups and to redistribute it towards further education in order to widen participation in education and training.

(Hodgson and Spours 1999 17)

In examining the impact of financial and inspection incentives on FE Colleges this article is critical of the use of P-A solutions in FE policy. A distinction should be made, however, between single-minded P-A solutions and P-A theory (Dixit 2002). Single-minded solutions assume basic information asymmetries and narrow definitions of self-interested college agents. Such single-minded (and silver bullet) solutions in the public sector are also criticised by P-A theorists such as Dixit (2002) who argue for more regard for professional values and intrinsic motivation if P-A theory is to be of value to policy (Dixit 2002, 697). Single-minded principal agent solutions in the public (and FE) sector contrast with P-A theory: a positivist research methodology which aims to determine the incentives which most effectively direct agents towards the goals of the Principal through a regard for moral hazard and adverse selection (see below). Unlike single-minded P-A solutions P-A theory is based on empirical evidence and may have a regard for multiple stakeholders and motivations beyond self-interest (Levacic, 2009).

Whilst we are mostly critical of single-minded P-A solutions in FE (as a means of meeting the needs of multiple tasks and stakeholders at the local level) a specific criticism of the positivist P-A research methodology underlying funding and inspection incentives in FE also relates to its view of college lecturers and managers as atomised rather than politically and socially embedded agents (Granovetter 1985) which, in turn, has had the effect of limiting the productive potential of learning cultures and communities of practice in FE (Scaife 2004; Lucas 2004; James and Biesta, 2007).

In analysing the impact of P-A theory underlying FE policy this paper does not measure efficiency in the orthodox way (quantitatively and through the use of counterfactuals). Instead

it looks inside the black box of the FE College, and qualitatively assesses the impact of inspection and funding incentives (with reference to the FE literature) through the application of Leibenstein's theory of X-inefficiency. X-inefficiency is the difference between the actual output from an input and the maximum output attributable to that input, with such a difference assumed to be the product of motivational deficiencies in the firm's (or College's) hierarchy (Leibenstein 1978). The use of X-inefficiency facilitates a regard for the impact of incentives on lecturer and manager self-interest, intrinsic motivation and professional values. In particular, it allows an analysis of the extent to which funding and inspection incentives in FE have facilitated the utilization of these productive motivational inputs in line with the human capital requirements of business (technical efficiency) at minimum unit cost (price efficiency), needs-based equity for disadvantaged learners and the wider benefits of education (exchange efficiency).

Analysis of the impact of P-A solutions on efficiency and equity is also situated more broadly within the conceptual framework of 'New Economic Sociology' (NES) which may be defined as the study of the social organisation of economic phenomena. Economic Sociology has a concern for both equity and efficiency, with these measured through the impact of processes (the traditional realm of sociology) on outcomes (the realm of economics). This focus, unlike orthodox economics however, is on understanding economic phenomena in its social and cultural contexts, an epistemology which recognises the importance of norms and values, trust, networks and social capital. New Economic Sociology also highlights the need to incorporate a regard for the political embeddedness of economic behaviour, and thus the impact of policy (e.g. local governance in FE) on agent (i.e. lecturer and manager) behaviour in colleges (Granovetter, 1985).

Whilst analysis in this paper of the effectiveness of P-A solutions is historical, it provides important caveats for the current Conservative administration to consider in the design of its new policy of localism and devolution, which is intended to shift decisions regarding the supply of employability skills from the centre to the local level. Analysis in this paper supports such localism but argues that for such localism to be effective there will need to be a significant shift away from the current low-trust Principal Agent solutions manifest in funding and monitoring systems, driven by marketization and managerialism, towards more flexible accountability arrangements such that government strategy is shared with localities through more decentralised forms of governance (Keep, 2016). Localism should also have a wider policy remit than the current policy focus on employability skills so that the needs of communities in terms of needs-based equity and the wider benefits of education may also be met.

1. Funding and inspection incentives between 1993 and 2015

As argued above, the design of funding and inspection incentives in FE to improve technical and price efficiency, is predicated on orthodox P-A theory. This includes *Moral hazard*, a term used by P-A theorists to describe a situation where the principal does not know how much effort is required to produce a given output. In these circumstances the principal (assuming agent self-interest) has to consider what incentive structure is conducive to increased output, whilst controlling for other factors which also impact on outputs (such as pupil characteristics) (Le Grand 2003). The problem of *adverse selection* relates to a situation where the agent has important information that the principal cannot access. Incentives are designed to elicit the truth (referred to as the revelation principle) which, if successful, causes the agent to share the economic surplus (rent) that exists in the relationship, and provide information that informs subsequent contracting decisions (Dixit 2002).

Under the Conservative administration (1993-1997), and the first five years of New Labour's administration (1997-2002), the Further Education Funding Council's (FEFC) formula funding methodology was the key means of addressing moral hazard within FE. This emphasized a concern for both technical efficiency (increasing outputs: in particular the number of students enrolled and retained on their courses) and price efficiency (reducing unit costs) by only funding student success in terms of enrolment, retention and achievement (Lucas 1999). This was predicated on a particular view of the previous LEA historical funding approach - that a lack of incentives acting on utility-maximising college agents had caused organizational slack leading to poor student retention and achievement in the sector (Audit Commission/Ofsted 1993).

Technical efficiency, under the FEFC, was thought to be realizable through the incentives (or funding signals) built into the formula funding methodology encouraging colleges to increase the quantity of outputs in terms of the larger volume of 16-19 year olds in the system, who needed to be retained and to achieve if funding units were to be realized. Improved price efficiency, it was thought, would also be encouraged because, unlike the previous LEA 'historical' approaches to funding, student dropout and failure to achieve would lead to a claw back of funds (Lucas 1999). Further improvements to price efficiency were further thought realizable through convergence in the average level of funding (the ALF), or unit cost of provision, which under LEA 'historical' funding approaches had been wide ranging, and technical efficiency through growth targets for expanding provision; in particular the DLE (Demand-Led Element) encouraged growth in colleges which derived £6.50 (a third of the ALF) for all units generated above the total number forecasted in the college's strategic plan (McClure 2000). This, combined with 90% core funding (core funding was calculated at 90% of the previous year's total each year from 1993 to 2002), meant colleges had to expand

provision just to receive the same level of funds as the previous year (FEFC 2001). Adverse selection was also addressed through the incentive structure which revealed cost structures through 90% funding, the Demand Led Element, and convergence in funding. The result was the achievement of government objectives in terms of an increased volume of students in FE, at reduced cost (McClure 2000). This, however, as discussed in more depth in section 2 below, did not equate to an increase in technical efficiency as the increase in volume of students was achieved through a decrease in the quality of education; in particular through the certification of lower quality work to meet student retention and achievement targets and to maximize funding units (Gravatt, 1997; Ainley, 1999, Ainley and Allen 2010). The significance of this for the Conservative administration's current agenda of localism relates to the potential use of skills targets at the local level, linked to (decreasing levels of) funding, incentivizing colleges to increase the quantity of students certified through gaming behaviours and a reduction in the quality of education outputs. Such behaviour may be required to secure funding for survival in the education market, but it would not equate to improved efficiency.

Under the Conservative administration (1993-1997) quality assurance and inspection procedures were also introduced to complement the FEFC formula funding methodology as a policy for remedying the problem of asymmetric information in the sector and to redress the lack of concern for the quality of education within the funding regime. To this end the FEFC inspected colleges on a four-year cycle, provided a three month period of notice for inspections and based inspections on colleges' annual self-assessment reports. FEFC inspections, however, section 3 below will explain, were ineffective at addressing poor quality provision as this was hidden through impression management activity and rituals of performance as a further means of college survival within the FE quasi-market (Elliot, 1996; Lumby, 2001).

The assumptions of P-A theory underlying FE policy continued under New Labour (1997-

2010). An increased focus on planning, however, led to more centralisation, with funding incentives used as the key means for directing colleges towards realising New Labour's economic agenda of meeting the human capital needs of business and needs-based equity for disadvantaged students (Hodgson and Spours 1999). Centralisation, under New Labour, was intensified in 2002 through the new state-purchasing agency – the Learning and Skills Council (LSC) – which increased funding associated with student achievement for 16-19 year olds (LSC 2002a) (10% of the base rate as compared to 7% under the FEFC). Further funding was also available subject to agreeing a three year development plan with the LSC built around the goals of increased customer focus, consistent high quality teaching and learning, and developing the capability of the college workforce (Success for all, LSC 2002b). In this way adverse selection was also addressed, through incentives designed to reveal information on the quality of teaching and learning.

Still more incentives to improve teaching and learning were introduced under New Labour on 1st April 2001 through a new inspectorate: the Office for Standards in Education (Ofsted), which replaced the FEFC as the institution responsible for ensuring quality and accountability of teaching and learning in the FE sector. Crucial to achieving a good Ofsted inspection grade on a four-point scale (1; outstanding, 2; good, 3; satisfactory, 4; unsatisfactory) was a college's retention, achievement and success rates compared to national benchmarks (national averages). Such benchmarks, in not incorporating a regard for the impact of student input characteristics on student attainment (e.g. the disadvantage of working class students in terms of social and cultural capital and material deprivation), were remiss in not adopting a value added approach, with this, as we shall see in section 2, creating the context for gaming behaviours to manipulate achievement and success rate PIs for course survival within the FE quasi-market (Smith, 2007; Boocock, 2014). Research on FE also suggests that X-inefficiency increased during this period

due to college conformity to the LSC and Ofsted creating an audit culture which undermined the productive potential of learning communities within colleges (Biesta and James, 2007). A key question for the current Conservative administration to consider relates to the role of Ofsted within its strategy of localism and devolution as a means of meeting the human capital needs of businesses (Keep, 2016), in light of a significant body of research which suggests that the response of colleges to Ofsted is one of institutional conformity rather than improved efficiency (Bathmaker *et al.* 2003; Smith and Bailey, 2005; Kelly, 2005; Boocock, 2010, O’Leary, 2015).

Needs-based equity was also addressed by New Labour in 2002 through a disadvantage funding uplift of 10% for enrolling basic skill learners or those students living in deprived areas (based on home address post codes), and a higher disadvantage uplift of 12% for enrolling those people living in supported accommodation registered with the local authority, provided by registered charities or housing associations (LSC 2002a). Section 3 below discusses how this objective of needs-based equity was significantly undermined in colleges by its other objective of improved success rates. In particular, it created the incentive for colleges to enrol disadvantaged students onto undemanding programmes of study as a means of improving success rates at the expense of the employability of such students (Wolf 2010).

The Coalition government’s (2010-2015) key objective in the funding of 14-19 year olds (through the Department for Education - DfE) and adult provision (through the Skills Funding Agency - SfA) was narrower than New Labour in its’ focus on developing the employability skills of young people and cutting costs. This included incentives for private sector companies to enroll employees onto courses provided in either the public or private sector, with the objective one of shifting the focus of the FE sector away from supply to meeting the demand for human capital (Keep and Mayhew 2013; Nash and Jones 2015).

The key criticism of this policy, addressed in more detail below in section 2, relates to the negative impact on efficiency and equity of government funding used by businesses to certify older employees' existing skills at the expense of both the skills of younger employees and the higher level technical skills required by industry (Lupton *et al.* 2015; Wolf 2015). A further criticism of the Coalition's funding of FE relates to the 24% decrease in funding of non-HE post-19 education between 2010 and 2014 (Keep and Mayhew 2013) which also impacted negatively on needs-based equity for disadvantaged adults.

Further incentives to address moral hazard were intensified by Ofsted under the Coalition administration through a change in the descriptor 'satisfactory' to 'requires improvement', and the requirement that colleges improve from 'requires improvement' to 'good' within two re-inspections or be labelled 'inadequate'. 'No notice' visits and a closer focus on senior managers' role in driving continuous improvement (to address adverse selection) were additional means by which college agents were incentivized to realize government objectives (Ofsted 2012).

In section 2 below we critique the single-minded P-A solutions discussed above. The key conclusion that centralized P-A solutions lead to incomplete contracts lends support to the current Conservative government's intended policy shift from central control to localism and devolution. It further suggests, however, that for such localism and devolution to be effective the Conservative administration will also need to shift away from its current ideology of marketization, managerialism and single-minded P-A solutions, towards more flexible P-A and accountability arrangements such that government strategy is genuinely shared with localities (Keep 2016).

2. X-inefficiency and incomplete contracts in the Further Education sector

It has been suggested that improved measures of performance in the FE sector are the product of the above funding formulae and college inspection regimes incentivising college agents to improve induction, recruitment, on-programme support and tracking of student progress (Ainley and Bailey 1997; Leney, Lucas and Taubman 1998; Lucas 1999; Hyland and Merrill 2002; Alton *et al.* 2007; Hodgson *et al.* 2015). Certainly, in New Labour's first two terms (1997- 2005) success rates increased from 53% in 1998/99 to 72% in 2003/04 (Foster 2005) and 77% in 2005-06 (Coffield *et al.* 2008). The number of 19-year olds with level 2 qualifications increased to almost 70% in 2006 and 1.6 million adults improved their basic skills through Skills for Life. This continued in New Labour's third term, with success rates for General FE and tertiary colleges for 16-18 year olds 77.3%, 78.3%, 79.1% in 2007/08, 2008/09 and 2009/10 respectively, and for students aged 19 and over 79.9%, 80% and 79.4%. Under the Coalition government success rates increased for 16-18 year olds to 81.6% and 84.1% in 2010/11 and 2011/12 respectively, and for students aged 19 and over 81% and 84.3% over the same period (SfA 2013). The success rate for all students in 2013/14 was calculated at 83.6% (SfA 2014).

The link suggested, between funding, inspection and education outcomes, however, is predicated on the assumption that measures of performance used in FE are valid and objective proxy measures of education outcomes. Such an assumption, we argue below, is tenuous in light of the more extensive FE research which suggests that improved measures of performance are the product of gaming behaviours and student certification rather than learning in the sector.

Gaming behaviours in the early post-incorporation period, under the FEFC, included ‘unit farming’, (alternatively referred to as ‘nesting’, ‘tariff farming’ or ‘additionality’) which involved extra funding units being derived not from enrolling extra students, nor by retaining them, but by entering them onto extra qualifications connected to their main course of study (Gravatt 1997). Such ‘unit farming’ was not a pedagogical policy based on student need, but a management policy cynically deployed to maximise funding units only. The policy, at its extreme, led to a 100 per cent increase in funding units at one college whilst student numbers actually dropped (Perry 1997). The ultimate way of ‘playing the system’ was through franchising. This was a way for colleges to exploit the demand-led element of the formula funding methodology through arrangements with employers to deliver courses on their premises, and in doing so to expand provision at lower marginal cost (a third of the ALF). The central problem to franchised provision was that it created incentives for colleges to receive money from the FEFC for provision which would have been provided anyway by the private sector (Nash 1995). Clearly franchising of this kind, in generating extra funding units for colleges and redistributing public finance to the private sector, with no real increase in provision for students, represented a policy which was neither technically nor price inefficient (Lucas, 1999).

New Labour’s continued use of single-minded P-A approaches in the funding of apprenticeships led to a similar ‘playing the system’. Between 2002/3 and 2009/10 there was a 67 per cent increase in apprenticeships, from 170,000 to 280,000, and between 2006/7 and 2009/10 a 273% increase in workplace learning, from 200,000 to 600,000 (Lupton *et. al.* 2015). 70% of apprenticeships, however, were not undertaken by new trainees but existing employees. As such, much of the workplace budget was used to fund training that employers would have provided without public funds.

Such technical and price inefficiency continued under the Coalition government's funding of adult apprenticeships. The financial incentives, government targets and lack of accountability, Wolf (2015) argues, allowed non-college (i.e. private) providers to certify experienced employees who did not require support or teaching materials, at the expense of 'more expensive' new employees who did need such support. Wolf (2015) also highlights how apprenticeships were in areas that were less expensive to provide rather than the highly qualified technicians required by the labour market. One further perverse, inefficient, inequitable and unintended outcome of financial incentives related to the reduction in apprenticeships started by 16-18 year-olds from 60% of the total in 2005 to 22% in 2013/14 (Wolf 2015).

The significant lesson to take from these findings is that the current Conservative administration's strategy of localism and devolution, should not include single-minded P-A solutions due to the creation of incomplete contracts and unintended perverse outcomes. In section 3 we outline the alternative more collaborative, ecological policy advocated by Hodgson and Spours (2015) which would mitigate incomplete contracts and perverse outcomes through the replacement of incentives (acting on self-interest) with collaboration (acting on communities of practice and professionalism) in the interest of multiple stakeholders.

Success rates in the FE sector may also only be considered a proxy measure for increased technical efficiency if such measures equate to improved education outcomes. A key caveat relates to the potential for increased achievement and success rates to be realised through gaming behaviours rather than improved teaching and learning. Ainley's research (1999) indicated that the FEFC funding incentives had led to a qualification inflation ('education by

numbers') and a certified society rather than a learning one. More specifically pass rates were achieved through increased student plagiarism and ghost-writing or through students approaching qualifications as 'simple exercise in information processing' (Ainley and Allen, 2010, 48). Ainley and Allen (2010), more recently, substantiate this claim with reference to the Kings College, London and University of Durham research (Guardian, 2009) which found no increased understanding of Maths, despite the significant increased numbers of students achieving A*- C GCSE grades between 1984 and 2009.

Boocock's five-year ethnographic study of a single FE College (2014) also revealed how success rates may be improved without any associated improvement in the quality of education. In particular, increased success rates on vocational courses were achieved through 'criteria chasing' (Spours, Coffield and Gregson 2006), a process which involved staff marking student work repetitively until all criteria are met, with this facilitated by pressure from senior managers on middle managers and, in turn, middle managers on lecturing staff to ensure the national benchmark was achieved. In this respect the introduction of success rates and benchmarks had encouraged dysfunctional principal-agent relations between managers and lecturers, with the use of success rates not about truthfulness, regarding education improvement, but with turning the department into an 'auditable commodity' (Shore and Wright 1999, 570, cited in Ball 2001, 11). More specifically, the focus was not on genuine effectiveness (New Labour's skills and egalitarian agenda) but on the appearance of effectiveness – effectiveness for the market and for Inspection (Ball, 2001; Smith, 2007).

The limitations of success rates are now understood by policy-makers. Indeed, the previous Coalition government, through the Department for Education (DfE), in response to the review of FE by Alison Wolf (2010), removed success rates from the funding formula because of a

view that they incentivise colleges to enrol students onto unchallenging courses to improve achievement. Success rates were also removed from the Ofsted inspection framework in light of a belated awareness that benchmarks do not have an adequate regard for how success rate benchmarks may be more easily achieved with higher ability students and less easily with disadvantaged students. The rhetoric has been one of increased recognition of the impact of prior attainment, socio-economic factors and local employment rates on student attainment within Ofsted's judgement of colleges (Ofsted 2012). The Department of Business Information and Skills (BIS) has also emphasised its intent to shift its focus from success rates alone towards a concern for longer-term outcomes such as student destination, employment and earnings (Fletcher *et al.* 2015).

It is highly probable, however, given the history of funding incentives in FE, that any new incentives introduced by the Conservative administration in its policy of localism and devolution will likely lead to further unintended dysfunctional outcomes. A recent example is the removal of success rates from the funding formula, which puts an increased emphasis on student retention. This is designed to prevent the perverse incentive created by the LSC funding formula relating to the recruitment of students onto unchallenging courses to ensure high success rates (DfE 2012). To further encourage recruitment with integrity, student withdrawal at any point, in the new funding system, will only realise 50% funding for colleges. Whilst this is designed to incentivise colleges to recruit the right students onto the right courses to optimise student retention (and funding) a new perverse incentive, given the political context of austerity, cost-cutting, and competition for students, might be one of enrolling less able students and thereafter 'criteria chase' (Spours, Coffield and Gregson 2006) (in other words endless marking and remarking of student work) to maintain student retention and, in turn, optimise college funding.

A further concern regarding the impact of single-minded P-A solutions in FE, relates to the question of whether or not an increased volume of lower standard qualifications is what is needed to meet the needs of the disadvantaged in colleges. If qualification success is the result of qualification inflation and lowering standards to maximise funding and measures of performance what does this mean for needs-based equity? The answer would appear to be that needs-based equity has not been improved through funding and inspection incentives in Further Education. Socio-economic gaps remain wide in the UK and they increase as children progress through the education system (Norris and Francis 2014), with children from middle class families able to benefit from social and cultural capital (Ainley and Allen 2010). Wolf (2010) explains how, under New Labour, this was compounded by a quarter of vocational education courses in Further Education not providing students aged 16-19 with prospects for employment or progression to HE. In 2013/14 the SFA removed 2,800 of these qualifications and in 2014/15 5,000 qualifications. Whilst these qualifications enabled colleges to achieve success rates, they failed to provide learners with progression routes into either employment or University (Lupton, Unwin and Thomas 2015), a situation self-evidently not in line with either improved needs-based equity or technical efficiency.

The view that funding incentives under New Labour led to improved needs-based equity was further brought into question by the UK's position of 25th out of 29 rich countries in 2010 for the number of NEETS (15-19 year-olds not in education, employment or training), its position of 18th out of 30 OECD countries in 2009 for the percentage of adults attaining a level 2 qualification, and adult numeracy skills significantly below the OECD average in 2011/12 (Lupton, Unwin and Thomas 2015).

Under the Coalition government (2010-2015) the use of single-minded P-A theory in FE may be particularly criticized for its impact on needs-based equity for disadvantaged adult learners.

More specifically, a narrow focus on developing (and funding) the employability skills of 16-19 year olds was at the expense of adult learners, with free study for adults on level 2 courses up to the age of 26, and level 3 up to age of 23, replaced with loans. This risked destroying adult education in FE which had been on a decline anyway, as a result of the 2003 skills strategy under New Labour which emphasised and funded adult literacy and numeracy skills rather than non-vocational learning. Adult participation in FE, as a result, dropped from 3,480,000 in 2002/3 to 1,500,000 in 2012/13. There has been a further drop in participation of adults aged over 24 studying level 3 and 4 qualifications from 400,000 in 2012/13 to 57,000 in 2013/14, caused by the replacement of free study with loans (Perry and Davies 2015). Such a policy is at odds with the public sector ethos which historically also had a concern for disadvantaged learners and education provision beyond the ‘human capital’ requirements of employers (Coffield *et al.*, 2008). It is unlikely that the current planned policy of localism and devolution, will redress the inequity of disadvantaged adult learners if, as the November 2015 spending review indicates, loans for adults are extended further to include all students aged 19-23 studying qualifications from level 3 to 6 (Kaczmarczyk 2016).

Needs-based equity for 18 year olds was also undermined, under the Coalition government, by a 17.5% cut in funding for 18 year olds relative to 16/17 year olds from 2014/15, impacting on 150,000 students (Isles, 2013), many from disadvantaged ethnic minority groups (Evans, 2013), and needs-based equity for students with learning difficulties was weakened through the removal of additional learning support for students up to the age of 18 which had been funded by the EfA. LEAs were charged with funding this support instead (extended up to the age of 25) but were unable, given their own significant cut backs, to provide the same level of provision as the EFA for students with learning disabilities (UCU 2013).

Overall, spending on FE between 2009/10 and 2013/14, whilst maintained in cash terms,

equated to a £1.2 billion or 10% cut in real terms (Lupton, Unwin and Thomas, 2015). Such a decrease in the Further education budget as a percentage of the total education budget was based on the view that there are higher returns from investing in HE than FE and that the higher earnings of graduates equates to increased productivity. This view erroneously conflates relative advantage with concrete productivity, as earnings can rise for the more highly educated without an increase in productivity, as is currently the case in the UK (Wolf, 2015). This suggests, on both egalitarian and efficiency grounds, that the declining funding of the FE sector as a percentage of the total education budget should be reversed within the Conservative government's planned policy of localism, to enable the sector to shift from low level vocational qualifications to higher technical level qualifications to meet the needs of the labour market. In this way, investment in vocational education would also improve needs-based equity through increased funding for disadvantaged learners (Wolf 2015).

A further significant negative effect of funding and inspection incentives, predicated on single-minded P-A theory, also relates to the prioritising of skills for employability over a regard for the wider benefits of education and exchange efficiency. In the early post incorporation period, for instance, consumer (i.e. student) instrumentalism in FE, and the need to meet funding targets for survival, caused colleges to focus on 'key transferable skills' at the expense of the wider social purposes of education (Ainley, 1999). The need to meet centralised targets and benchmarks under New Labour continued to cause inertia in colleges at the expense of the innovation required to meet the needs of learners and local communities. To redress this Lucas (2004) argued for a less controlling, more decentralised, approach to funding so that the curriculum may be developed in accordance with local Business and community needs rather than distant LSC directives.

Under the Coalition administration funding drivers introduced by the SFA also failed to recognise the value of the wider benefits of lifelong learning which:

Boosts individuals' skills and strengthens communities and contributes to better health and wellbeing. Research shows that where people are engaged in adult learning there are positive outcomes for health in relation to smoking, cancer, obesity and general wellbeing. It is not only good for individuals but a positive saving for the NHS (Dakin 2013, 30)

There would appear to be clear limitations to policy based on P-A (Principal-Agent) theory for the current Conservative administration to consider in its planned policy of localism and devolution - notably the difficulty of determining incentives given the multi-task and multi-principal nature of Further Education, and poorly observable goals. If the Conservative administration, in developing a policy of localism, is to meet the needs of businesses and disadvantaged students more regard for local knowledge, professional values and intrinsic motivation will be required (Dixit 2002, 697). A shift in policy from central diktats and funding and inspection incentives (which create incomplete contracts) to local decision-making may facilitate this, but localism and devolution will be required to go beyond the current focus on the human capital requirements of business if incomplete contracts are to be avoided; in particular it will also be required to consider issues of equity at the local level and the wider benefits of education such as the emotional development of students, health issues, society and citizenship (Dixit 2002, 718).

3. Principal-Agent relations between policy-makers and senior managers

In this section the impact of single-minded P-A solutions on relations between policy-makers and senior managers is highlighted as a significant causal mechanism for the inefficiencies and inequities discussed in previous sections.

The use of single-minded P-A solutions in the FE sector has consistently privileged rational goals and hierarchy forms of governance over open systems and self-governance (Newman, 2001). This has encouraged conformity with central policy diktats at the expense of senior manager agency and local decision-making, and required senior managers to present their colleges as ‘auditable commodities’ (Shore and Wright 1999, 570, cited in Ball 2001, 11). In other words, a culture of performativity has emerged - ‘a technology, a culture and a mode of regulation that employs judgements, comparisons and displays as means of control, attrition and change’ (Ball 2001, 2), leading to student commodification - a process whereby students are viewed as commodities, of financial or presentational value, at the expense of more legitimate educational decision-making.

Lumby’s (2001) survey of college managers illustrated how senior managers felt unable to be self-critical because of the need to impress governors, and governors not being able to expose weaknesses to the FEFC in fear of a poor inspection report. This was compounded by an inadequate upward flow of communication in FE Colleges caused by senior college managers giving unconscious signals that ‘ideas, reactions and criticisms are not welcome’, a process which leads other managers in the hierarchy to filter what they say (Lumby 2001).

The increased focus on rational goals (targets and PIs) and hierarchy forms of governance under New Labour led to P-A relations which were even more controlling. Rennie’s research (2003), for instance, found college activity, in response to the Ofsted inspection framework, to be more akin to a theatrical production or ‘performing performance’ (Smith and Bailey 2005)

than a process of college improvement. In other words, virtual colleges were constructed for show rather than for what is actually done, requiring actors to be coached and rehearse lines, with the theatre (i.e. college) cleaned and props (i.e. reams of quality assurance documentation) at the ready. The performance carried on with the production and measurement of quantitative performance measures, which were of greater importance to both college managers and inspectors alike, than the explanation for the measurement itself (p.14), and thus its accuracy and validity. Similarly, the research of Kelly (2005) found that audits of quality in FE were more focussed on ensuring the quality of control systems, by making practices and behaviours visible and measurable, at the expense of the primary focus of colleges in terms of providing improvements in the quality of education (p.7); in other words Colleges were more focussed on the 'rituals of verification' than with genuinely reflecting on existing work practices. At the extreme the research of Coffield *et al.* (2008) uncovered colleges experiencing 'external reproduction' – where policy levers, rather than being mediated by senior managers, became the main objectives, leading to frequent reorganisations, remote management and excessive bureaucracy and control over professional practice (Coffield *et al.* 2008, 148).

Similarly Boocock (2010), in a five-year ethnographic study of a single FE College uncovered senior managers focussing on goals and systems rather than on cultural change and innovation. Within this context, management was less concerned with improving efficiency and equity through an internal concern for developing the motivational structure of the college (and the productive potential of staff) than with conforming to and being legitimised by Ofsted and the LSC. Such a scenario was in line with what institutionalists refer to as 'coercive isomorphism':

Organisational success depends on factors other than efficient coordination and control of productive activities. Independent of their productive efficiency, organisations which exist in highly elaborated institutional environments and succeed in becoming

isomorphic with these environments gain the legitimacy and resources needed to survive.

(Meyer and Rowan 1977, 98)

‘Coercive isomorphism’ in this case related to a larger organisation (both the local LSC and Ofsted) dominating a smaller one, leading to rituals of conformity (DiMaggio and Powell 1983) and a simultaneous reduced focus on developing technical activities (in particular systems and procedures) contingent on the particular needs of students and the local community. In other words, incomplete contracts, manifest in rules and constraints, seemingly limited the productivity of goal-oriented intrinsic motivation and professional values (Leibenstein 1978, 260).

Incomplete contracts have been further limited under the Coalition and the current Conservative government; in particular through a funding formula which no longer incentivises but directs senior managers towards young people at the expense of both adult learners and needs-based equity, and an inspectorate which maintains rituals of verification through short notice inspections. Whilst governments can ensure compliance through funding and inspection steers they are unable to forecast the outcomes of incentives or fine tune them to prevent inefficient and inequitable outcomes. (Fletcher *et al.* 2015, 173). ‘Measures of quality (also) ignore what is meaningful when what is meaningful is difficult to measure’ (Orr 2015, 175)

The current Conservative administration’s policy agenda of area reviews as a precursor to a more localised and devolved approach to decision-making may provide progressive possibilities but the administration will need to go further than the planned focus on employability skills by including a regard for the needs of communities and disadvantaged adults at the local level too. It should also avoid replicating P-A solutions used at the national level at the local level due to the dysfunctional outcomes and incomplete contracts created.

Hodgson and Spours (2015) provide a broader template for addressing skills, needs-based equity and the wider benefits of education (for communities) at the local level through a shift from marketization and managerialism to area-based collaborative approaches in which FE colleges can use local knowledge to contribute to regional ecosystems. This would entail an emphasis on democratic local governance rather than central policy steering through inspection and funding incentives. In particular, colleges would be accountable, not to the diktats of central government, but to local communities, learners, employers, other education providers in the local area, and to regional and national professional associations. There would be a clear set of learning entitlements and devolved power at the local level, with this facilitated by change at all levels of governance – national, regional, local and institutional, and colleges liaising with wider social partners in a more collaborative and economically connected local learning system. Coffield *et al.* (2008) similarly argue that local innovation could be achieved by replacing the ‘micro-managed, target-driven and quantitative culture of accountability’ (186) with bottom-up area-wide targets and a flexible funding mechanism (based on broadly based, rather than specific targets over three years) so that ‘translation of policy’ and resource allocation within colleges is in line with local circumstances rather than distant LSC directives.

Crucially, more flexible P-A relations involving area-based collaborative approaches would resolve the problem of incomplete contracts (created by centralised funding and inspection diktats) as Colleges, in collaboration with local partners, would be able to develop curricula in line with the needs of disadvantaged students and adults, as well as the human capital needs of business, rather than centralised government diktats. The realisation of such a localised strategy, in valuing intrinsic motivation and professionalism as more powerful motivators in the Further Education sector than the self-interest assumed within principal-agent solutions, would be in line with communitarian theory. Moral commitment, within this context, would

be achieved, not through incentives acting on self-interest, but through the college community imposing norms (patterns of behaviour, based on community values, such as reciprocity, co-operation, work norms, moral norms) on the actions of individual managers and lecturers within the community (Etzioni, 1996 cited in Robertson *et al.* 2005). In particular, the sharing of power with local stakeholders and the empowerment and participation of middle managers and lecturers in decision-making (Robertson *et al.* 2005, 12) would improve organisation design, managerial practices and teaching and learning through the utilisation of lecturer professionalism and intrinsic motivation in line with the needs of local businesses and communities.

Price efficiency would also likely improve because of the reduction in transaction costs associated with policy based on higher trust (the costs involved in establishing, monitoring and enforcing the contract between the state purchasing agency and the FE College (Lane 1998, 262), and between managers and lecturers. More specifically the high transaction costs relating to 'time and energy put into translating external demands into internal systems of accountability' (Coffield *et al.* 2008, 153) would be reduced.

4. Principal-Agent relations between managers and lecturers

The question arises, given the controlling principal-agent relations between policy-makers and senior managers discussed above: what is the impact of this, in turn, on principal-agent relations between senior managers, middle managers and lecturers? There is considerable research which suggests that external control was internally reproduced in FE Colleges in the early post-incorporation period (under the Conservative administration), leading to controlling P-A relations between senior managers, middle managers and lecturers (e.g. Hodkinson and Harvard, 1994; Randle and Brady 1997a, 1997b). The significance of this, research further suggests, is that that the professional knowledge and judgement of lecturers was challenged by

a culture of compliance and depoliticisation of the teaching profession, with such compliance imposed on lecturers by senior managers through ‘contrived collegiality’ (Bathmaker *et al.*, 2003).

In particular, controlling P-A relations between college leaders, managers and lecturers led to lecturer professionalism being usurped by pressure on course teams to accept a dominant group ethos fully accepting of new managerialism (Avis 2002). Such *managerialism* was based on economic rationalism, involving management control over professionals, and the replacement of public sector management with (what was considered) more efficient private sector practices (Clarke & Newman 1997). The importance of this, in terms of principal-agent relations, relates to the role of senior managers in the systematic disempowerment of lecturers and middle managers to determine what constitutes effective pedagogy for the needs of students, employers and wider society (Randle and Brady 1997b, 236). Such a scenario is sometimes referred to as the deprofessionalisation (or proletarianisation or de-skilling) thesis (Randle and Brady 1997b).

There is some debate on the role of middle managers in this process. Some research suggests that middle managers have acted as an ideological buffer between managerialist notions of professionalism and those of lecturers (Gleeson and Shain 1999), resisting or even subverting policy through principled dissent (Coffield 2014) or infidelity (Wallace and Hoyle 2007). Tactics may be covert in nature, and include invisibility and impression management, as a means of prioritising ‘students and teachers over the systemic reporting structures and financial imperatives upon which colleges are built’ (Page 2015, 127). Other research suggests that middle manager have a limited capacity to resist senior manager diktats within hierarchical and authoritarian organisational structures (Hannagan, Lawton and Mallory 2007; Gleeson and Knight 2008; Boocock, 2011).

Under New Labour a new regime of inspection and target-setting tightened P-A relations through top-down management and a more bureaucratic audit culture (e.g. Hodkinson 2005a, 2005b, Hodkinson *et al.* 2007) which further de-professionalised lecturers at the expense of intrinsic motivation and tacit knowledge. In particular, an emphasis on retention and achievement benchmarks by Ofsted and LSC led to on-going changes in systems and procedures, which reduced the morale of lecturers and created a ‘culture of the now’ (Scaife 2004): a culture in which colleges respond quickly to the short-term needs of accountants and consultants, with little time or space for longer-term reflection or on-going research (Scaife 2004, 1). In this way, productive motivational inputs derived from lecturer agency and the pedagogic judgement of lecturers (Nixon *et al.*, 2008) were marginalised from the production process, with X-inefficiency (Leibenstein, 1978) the result of top-down, hierarchical decision-making. The audit culture, in focusing on compliance, also limited collaborative activity (of benefit to social capital) which required the co-ordination of people, systems and technology (Iszatt-White *et al.* 2004; Collinson and Collinson 2005) through leaders ‘sharing power, authority, knowledge and responsibility’ to create ‘synergistic, dynamic processes of active engagement’ (Jameson 2007, 11-12).

The OTL (Observation of Teaching and Learning) process, driven by the Ofsted inspection framework, exemplifies the limitations of the audit culture created by controlling P-A relations. Under New Labour and the Coalition government, Observation of Teaching and Learning became the dominant quality assurance system for improving teaching and learning (Armitage *et al.* 2003). In Foucault’s (1980) terminology, it acted as an apparatus of control; in other words a top-down process which controls organisational life through the introduction of technicist skills and a culture of performativity (O’Leary, 2015). The teacher, within this context, has been reconstructed as state technician who uses assumed pedagogical practices

designed by Ofsted, with learning outcomes made visible and accountable, and alternative approaches to teaching and learning limited. (Maguire 2010, cited in O’Leary 2015, 16).

The pressure on teachers to uncritically accept OTL has increased under the Coalition and Conservative administrations, through the replacement of the ‘satisfactory’ grade with ‘requires improvement’ in the inspection framework. This has intensified the use of graded observations as a normalized, performative tool concerned with teacher accountability, and the lecturer response of rehearsed and conformist teaching and learning, at the expense of teacher development. In this way the regime of truth in OTL, created by Ofsted and reinforced through managerialism within FE colleges, has facilitated conformity to Ofsted rather than improvements in teaching and learning (O’Leary, 2015). To prevent a ‘pedagogy of compliance’ usurping ‘informed professional judgement’ (Alexander 2004), Boocock (2013) argues for reform of the observation process; in particular a shift from narrow definitions of ‘good’ and ‘best’ practice and the competent practitioner model (Coffield and Edward 2009) towards:

A less threatening and hierarchical OTL process which both embraces the tacit knowledge, professional values and subject-specific pedagogy of lecturers within their learning communities, and challenges lecturers (in their communities) through reference to pedagogical debates and research within the FE and wider literature (Boocock 2013, 499)

The question arises as to how government policy should be changed to ameliorate the tight P-A relations and incomplete contracts discussed above, so that the productive potential of lecturer and middle manager professionalism, intrinsic motivation and social capital may be utilised to achieve organisational goals. The current Conservative government’s planned policy of localism and devolution may not achieve this if P-A solutions are merely transferred from the national to local levels and, in particular, if Ofsted is retained in its current form as an

apparatus of state control. It will also not be achieved if the content of the curriculum is increasingly determined (as with apprenticeships) by employers rather than a range of stakeholders. This will particularly be the case from 2016/17 if employers (who will be expected to contribute £1 for every £2 of government spending devolved to local authorities) are able, as planned, to decide the content of apprenticeships, with this supported by the revised 2015 Ofsted inspection framework which puts an increased emphasis on the responsiveness of FE providers to local skills training needs (Kaczmarczyk 2016).

The more collaborative ecological policy outlined by Hodgson and Spours (2015), discussed in section 3, would provide more flexible principal-agent relations between policy makers and college leaders. This, in turn, would also provide an opportunity for more flexible internal principal-agent relations between managers and lecturers. In particular college leaders would be more able to support the ideal learning cultures and communities of practice argued for in the FE literature (James and Biesta, 2007) and encourage a shift in the nature of professionalism from neoliberal or managerialist professionalism, involving compliance, hierarchy, homogenous work procedures and low trust, to democratic professionalism, involving engagement in new developments in teaching and learning, and collaboration between lecturers and external stakeholders (students, parent and the wider community), focused on meeting the needs of the institution, local employers and the wider community (Taubman 2015).

Such democratic professionalism would also require a fundamental shift away from tight coupling in the sector (i.e. simple-minded P-A solutions and narrow definitions of effective teaching and learning) to loose coupling; in other words a more specific emphasis on people, relationships and learning, rather than centrally determined rules, regulations and incentives within formal or bureaucratic control. In particular it would involve a loose relationship between lecturer, college and the centre, to allow adaptability and effectiveness (Orton and Weick 1990, cited in Goldspink, 2007, 40) within a complex and uncertain environment.

Conclusion and recommendations

Much of the FE literature on the post-incorporation FE sector suggests that government diktats, predicated on single-minded P-A theory, whilst effective at driving through and enforcing government policy, are less effective at improving efficiency and equity. This is because centrally determined diktats (such as funding incentives and inspection frameworks) marginalise both local knowledge of labour markets and communities and the intrinsic motivation and tacit knowledge of college staff from the production process. The solution, research on FE suggests, is a shift from central control to a more loosely coupled FE sector including decentralised area-based collaborative approaches to decision-making. This would mitigate incomplete contracts, enabling manager and lecturer professionalism and tacit knowledge to be used (in consultation with local businesses and communities) to meet the human capital needs of local businesses, needs-based equity for disadvantaged students, and the wider benefits of education.

The current Conservative administration aims to improve skills for employability through a policy of localism and devolution. If such localism is to be effective far more local autonomy will be required than has so far been granted in terms of funding and curriculum delivery (Gravatt, 2014). In particular, an effective policy of localism will require a significant shift away from the current low-trust Principal Agent solutions manifest in funding and monitoring systems, driven by marketization, managerialism, 'targets and terror' (Propper, 2010, p. 34, cited in Keep, 2016, p. 4), and control at the level of a national agency. More recognition of local knowledge will be required, and trust in subordinate actors and local stakeholders to use this knowledge to meet local needs. To facilitate this will require the development of new mechanisms to enable localities to confederate, the DfE and BIS to create more flexible

accountability arrangements with localities, and government to distribute or share strategy with localities through new forms of governance (Keep, 2016, p. 8). These new forms of governance and accountability arrangements, this paper argues, should also have a broader remit than skills for employability at the local level, to include a concern for needs-based equity for adults and the wider benefits of education to local communities.

The review of the FE literature in this paper also suggests that the current Conservative government is unlikely to achieve its goal of increased skills for employability, if its policy of localism creates a local version of the ineffective national supply-led approach to skills implemented by previous administrations (Keep, 2016). This may particularly be the case if single-minded P-A solutions shift from the national to the local level in terms of skill targets provided to local providers which are broken down according to skill levels and vocational areas in an attempt to match the supply of skills with demand. Such a policy at a local level would likely lead to the same incomplete contacts, gaming behaviours and unintended consequences that national funding and inspection targets previously created, and fail to deliver the looser coupling (i.e. more flexible P-A relations) required for managers and lecturers to develop the curriculum in line with the needs of businesses, disadvantaged adults and local communities.

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