

25 Ways to Reduce the Cost of College

#25: Promote Competition Based on Value, Not Reputation

Abstract

In most areas of human economic endeavor, competition manifests itself in lower prices. If company A has competition from companies B, C, and D in selling a good or service, the competition will lead A to lower prices to fend off loss of sales to B, C, and D. In higher education, however, it seems as if competition leads to higher prices, as schools seemingly “compete” to spend greater sums of money. There seems to be an academic “arms race” resulting in vast increases in spending on, for example, luxurious student recreational facilities, expensive superstar professors, or football coaches.

Schools largely compete on reputation, quintessentially measured by the *U.S. News & World Report* college rankings. Spending more money can lead to higher rankings. To get more money, schools raise tuition rates and engage in incessant searches for grants and gifts. Since third parties fund a large portion of the bills, students are relatively insensitive to price. Very little college advertising speaks of being “the low cost alternative” or the “best bang for the buck,” unlike with, say, automobile advertising.

A fundamental problem is the lack of information—quality and value are related to results, and colleges are secretive and sometimes even ignorant about their success in educating students or preparing them for a vocational future. A second problem is that third-party funding and the non-profit nature of most institutions dull the incentives for colleges to try to minimize the price of their services. The FAFSA form enables colleges to price discriminate, choosing sticker prices higher than they would be in the absence of such information.

The most critical element in any solution is the obtaining of value-added measures of what students gain from college, both in terms of knowledge and in terms of other attributes, such as critical learning skills. This requires nudging colleges to provide more information in a useful fashion. It requires that true cost to the student be made available accurately and early. It might depend on changing compensation systems for key employees to emphasize the value-cost relationship, rewarding officials who manage to keep costs down.

Released in 2010

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Acknowledgements

The Center for College Affordability and Productivity would like to thank Lumina Foundation for its generous support of this research.

Lumina Foundation for Education is an Indianapolis-based private foundation dedicated to expanding access to and success in education beyond high school. For more details on the Foundation, visit its Web site at www.luminafoundation.org.

The views expressed in this publication are those of the authors and do not necessarily represent those of Lumina Foundation for Education, its officers, or employees.

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#25: Promote Competition Based on Value, Not Reputation

While higher education is intensely competitive, the result is not as beneficial as we've come to expect from highly competitive sectors. In fact, a good case could be made that many of the competitive pressures and resulting actions, such as turning away students yearning for an education, are downright harmful. Luis M. Proenza, the president of the University of Akron recently asked, "[Why] are universities judged by the number of students they exclude, or by how much they spend? Why aren't they judged by how well they teach, and at what price?"⁶¹⁴ That is a key question, and the answer has a lot to do with the type of competition we see in higher education.

The Importance of the Type of Competition

Social scientists have known since the 18th century that competition can be very useful in ensuring desirable outcomes. In *The Wealth of Nations*, Adam Smith introduced the concept of the Invisible Hand to describe how the competitive pressures exerted by markets can guide large numbers of people to pursue socially beneficial goals for self-interested reasons. Competition is so important for the proper functioning of markets, that the absence of it, referred to as monopoly, is considered a market failure, and we typically respond by having the government either take over the industry, or heavily regulate it.

As many observers will tell you, competition is ever present in higher education. Institutions of higher education flood the best students with glossy brochures and merit scholarships in the hopes of enrolling them, engage in bidding wars with each other over prize-winning professors, and are widely seen to be engaged in a building spree driven by one-upmanship. Competitive pressures are so great that many schools compromise their academic standards to win on the athletic field. Some will also compromise their principles and integrity when they use preferential admissions to admit the offspring of alumni and donors over other applicants who are academically more qualified.

As should be clear, competition can lead to both desirable and undesirable outcomes. Unfortunately, the current competitive pressures in higher education lead disproportionately to undesirable ones. To see why, we must distinguish between different types of competition.

When we think of competition, we typically think in terms of what we will call value-based competition. Consumers seek out the goods and services that give them the highest cost adjusted satisfaction, and producers vie with each other to provide those goods and services. Both consumers and producers know a lot about the good or service in question, most importantly its price and quality. Of course, not everyone gets the same benefits out of the

⁶¹⁴Don Tapscott, "Impending Demise of the University," Edge.org, 4 June 2009.



same thing – preferences vary. Moreover, consumers are constrained by their budget – most of us would like to drive a Bentley and eat at Morton’s Steakhouse every night, but few of us can afford to do so. These differences in preferences and budget constraints give producers an incentive to compete along two dimensions, price (which determines the costs for consumers) and quality (which helps determine the satisfaction consumers get). They can succeed by providing a good or service of a given quality for less money, lowering the cost for consumers. Alternatively, they can provide a good or service of higher quality at a given price, increasing the satisfaction that consumers receive. Note that both of these options provide incentives for the company to seek ways to cut costs without harming quality too much and to improve quality without increasing costs too much. In other words, competition ensures that it is in the interests of producers to provide goods and services of various qualities at as low a cost as possible, because that is what consumers want.

However, for value-based competition to work, both producers and consumers (but especially consumers) need good information about the relative qualities and prices of the goods and services that are available. In an information starved market, competition tends to be based on reputation instead of value, and some of the beneficial outcomes that normally accompany competition are lost, while some unsavory consequences are added.

What Kind Do We See in Higher Education?

Most observers have concluded that reputation plays a central role in the competition among institutions of higher education. The influential *US News and World Report* rankings even use reputation (referred to as peer assessment) as 25% of their rankings. Institutions of higher education fail to compete along either of the traditional dimensions of value for the simple reason that neither price nor quality is widely known.

While the published tuition for each college is publicly available, the existence of substantial discounting by the schools, as well as governmental financial aid, renders reliance on these published figures ill-advised. Many students suffer from “sticker shock” and don’t apply to schools that they could afford to attend once their aid is taken into account. The figure that should be of real interest for students is the tuition net of institution and government aid, but this is not revealed to students until *after* they have applied to and been accepted by a school. This deprives students of some very important information. Needless to say, it is very hard to compete on price when not everyone knows the price.

More importantly, the quality of an education provided by one school relative to another is unknown. While people certainly have opinions on which schools are better, they are mostly just repeating what they have heard others say. People primarily rely on public perception when trying to determine quality. To illustrate just how heavy this reliance is, consider two real schools, College of the Atlantic and Rocky Mountain College, and suppose I asked you to determine which offers a higher quality education. Since most of us have never heard of either of them, we cannot rely on reputation to guide us. Starting from scratch, it becomes quite clear



just how difficult it is to even come up with a plan for how you could determine which is better, let alone where you could find the relevant information (assuming it even exists).

Even if we have objective measures of some outcomes such as graduation rates, job placement, or the starting salaries of graduates, the fact that universities don't choose which students to admit randomly, but rather make deliberate choices, introduces a selection bias that is hard to get around. Suppose, for example, that we knew that Princeton graduates had higher incomes and are more involved in the community than Ohio State graduates, on average. We should not conclude from this information alone that Princeton provides a better education. If the students from Princeton had characteristics such as higher test scores, more extracurricular activities, or a more wealthy background, it is likely that those students would have had higher incomes and greater community participation regardless of where they went to school. The fact that elite schools like Princeton enroll a disproportionate share of these students renders simple comparisons biased – we can't say that Princeton is better because we don't know how much of the observed differences are attributable to a Princeton education. In the words of William Fitzsimmons, dean of admissions at Harvard, "At Harvard we get terrific students, and we turn out terrific students later on. Is that due to Harvard or is that due to the students to begin with? Who knows?"⁶¹⁵

What we need to evaluate the contribution of specific schools is a measure of their value added impact. However, since the value added education provided by a school (how much of the education is attributable to the school as opposed to the student) is unknown and not measured, it is impossible for students to use the true quality of a school as a factor in determining where to attend. In the words of Derek Bok, "since applicants are generally hard-put to know just how much they are really learning, let alone how much they can expect to learn at a school they have never seen, they do not make enlightened choices."⁶¹⁶ Moreover, the "lack of good information about the quality and value of higher education is creating a situation in which student-customers bear most of the risk for their long-term investment in their own education with little insight into what would work best for them."⁶¹⁷

Since students can't rely on true quality to inform their decisions, they rely on proxies. Common proxies include selectivity and published tuition (with more selective and more expensive colleges seen as being better). But perhaps the most important proxy for quality is a college's reputation. "If college reputations were based on objective, publicly available measures of student learning, that would be okay. But they're not, because no such measurements exist."⁶¹⁸ Knowing that potential students use reputation as a gauge of quality, colleges compete

⁶¹⁵ Sara Rimer, "Studey of Standardized Admissions Test is Big Draw at College Conference," New York Times, 28 September 2008.

⁶¹⁶ Derek Bok, Universities in the Marketplace: The Commercialization of Higher Education, (Princeton, New Jersey: Princeton University Press, 2003).

⁶¹⁷ Louis Soares, "Putting the Customer First in College: Why We Need an Office of Consumer Protection in Higher Education," Center for American Progress, November 2009.

⁶¹⁸ Kevin Carey, "That Old College Lie," Democracy, Winter 2010.



vigorously to improve their reputation. Unfortunately, there is little reason to believe that there is a strong correlation between things that improve a school's reputation and things that improve learning.

In sum, because neither price nor quality is known, the standard competitive pressure to compete along the price and quality dimension is missing in higher education. Instead, competition is largely based on reputation, and basing competition on reputation works against the consumer.

Why Reputation Competition is Even Worse in Higher Education

The fact that competition in higher education is based on reputation would not seem to be that problematic, but several unique features of the industry combine to yield some particularly unpleasant outcomes. The three most important features are peer effects, an extreme uncertainty about quality, and status.

Peer Effects

Peer effects, the fact that what one student learns depends on the other students on campus, enhances reputational pressures. Suppose for a moment that we had perfect information on college quality; it might seem plausible that some schools would compete by lowering their price. However, this is discouraged by the notion that the quality of fellow students is a determinant of the quality of education that the students receive. While the exact mechanisms that produce the effects continue to be debated, it is generally accepted that students in a peer group with "good students" are more likely to be good students themselves than if they had peers who were "bad students."

Peer effects have implications for the competitive pressure that institutions face. For instance, the following scenario demonstrates how peer effects makes competition along the basis of price highly unlikely. Suppose there are two colleges that are exactly that same, Discount U. and Cream of the Crop U., and a generous donor gives each of them the same large donation. Discount U. decides to use the money to compete based on price and lowers their tuition for all students, effectively giving a discount to all students. Initially, this results in a greater number of applications and a slightly better (academically) student body. Cream U. decides to use the money to offer merit scholarships targeted towards the cream of the crop, trying to attract excellent students. They are essentially cutting tuition, but only for exceptional students. While their total applications will not increase very much, the quality of their student body will see significant improvement as exceptional students flock to the university, attracted by the relatively large scholarships that are being offered to them.

At first, Cream U. sees a much bigger improvement in their student body since they concentrate all of the money on bringing above average students to campus whereas Discount U. spread their donation over the entire population of students, half of whom are below average.



Because of peer effects, the improvement in the quality of Cream U. becomes even more pronounced thanks to a feedback effect that essentially acts as a multiplier for quality improvements.⁶¹⁹

Over time, the good students who previously attended Discount U. now decide that they want to attend Cream U., which is of course willing to accept them. As Cream U. “poaches” many of the good students from Discount U., the quality of Cream U. continues to increase, while the quality of Discount U. starts to decline. A new equilibrium is established in which Discount U. is lower cost and lower quality, and Cream U. is higher cost and higher quality. Those in charge of universities - the boards, administrators, and faculty - would all tend to prefer to be a Cream U. rather than a Discount U. Thus, the existence of peer effects indicates that competition is more likely to occur along the quality, as opposed to the price, dimension. However, this is very problematic because it turns out that quality in higher education is unknown.

Uncertain Quality

Higher education is not the only industry that relies on reputations. For instance, restaurants, lawyers, and car companies all depend on reputations to some extent. However, it is crucial to note that their reputations are subject to continuous updating which either reinforces or erodes the initial reputation-based on actual performance. You know whether you had a good or a bad meal at a restaurant, or whether you got stuck with a lemon, and this information is used to update not only your own perception but also the perceptions of those you interact with.

When it comes to higher education however, how do you know whether you got a good or a substandard education? Unfortunately, it is nearly impossible to know. Some effort is made to examine difference between college graduates and those who did not attend college, but virtually no effort is made to distinguish how much of these differences are attributable to the college. Moreover, students only get one of each type of degree, so even if they transfer they can only directly compare one or two schools. In other words, there is a lack of information about the outcomes of college, and this in turn means that there is very little with which to update reputations, unlike in other reputation-based markets. While a restaurant that serves terrible food will lose customers even if it started with a great reputation, a college or university that does a terrible job educating its students will not be punished if it has a great reputation because no one knows that it is doing a terrible job. Similarly, a school that starts with a bad reputation, but does a terrific job of educating students will still be perceived as bad.

The lack of reliable updating of reputations gives rise to a catastrophic problem – stagnation. While everyone relies on reputation as a proxy for quality, since quality is unobserved, reputations cannot be updated. Since reputations are not updated, they become ossified, and

⁶¹⁹ Caroline Hoxby, “How the Changing Market Structure of U.S. Higher Education Explains College Tuition,” [NBER paper 6323](#), 1997.



can start to deviate very far from actual quality. To illustrate this problem, consider the following. In what years did U.S. News and World Report rank, in any order, Yale, Harvard, and Princeton as the top three schools? The answer is 2009-10, 2008-09, 2007-08, 2006-07, 2005-06, 2004-05, 2003-04, 2002-03, 2001-02, 2000-01, 1998-99, 1996-97, 1995-96, 1994-95, 1993-94, 1992-93, and 1989-1990. In fact, going through the entire history of the rankings, 1999-2000 was the only year when at least two of those schools were not in the top three. Apparently, not much has changed in the past 26 years. As Clark Kerr observed, “Everything else changes, but the university mostly endures.”⁶²⁰

The same schools can remain on top year after year because higher education is so heavily dependent upon reputation, and reputations are not updated due to a lack of information of their value added impact. “The strongest universities tend to perpetuate themselves almost automatically. Success begets more success, which helps to explain why the list of top-rated universities in 2000 looks remarkably like a similar list in 1950 or even 1900.”⁶²¹ To get a feel for just how stagnant higher education is, compare the turnover of top schools to the turnover of top companies. While the list of top schools remains the same for decades, even centuries, it is an entirely different story when it comes to top companies. Of the 20 top companies in the *Fortune 500* in 1955, only 4 were in the top 20 in 2009, and only 10 were in the top 1,000. In other words, half of the top companies in 1955 had either ceased to exist, or had fallen off the list entirely a mere 54 years later. Of the 75 companies that broke into the top 20 from 1955 to 2009, the average number of years they stayed there was just 13 years.⁶²² The median was even lower – 6 years.

The rapid rise and fall of institutions that we observe in the rest of the economy is completely absent in higher education. Nor is this a new phenomenon – fully 70 out of 85 institutions established by 1520 that are still in existence today are universities.⁶²³ Colleges and universities have either somehow managed to be the best run institutions in the world for the past five centuries, or else there is a fundamental problem when it comes to evaluating their quality.

College as a Status Good

The last factor that makes reputational competition in higher education dysfunctional is the idea of college as a status good. The prestige of a college matters. Parents and students view a degree from a highly selective college as more valuable than a degree from a lesser known college, regardless of what the colleges do in terms of educating their students. Perhaps the most important source of this phenomenon is the fact that one of the fundamental functions of selective colleges is to screen their applicants. By only accepting above average applicants, selective colleges are pretty much guaranteed to have above average graduates. The signal of

⁶²⁰ Clark Kerr, “The Uses of the University,” (Harvard, Massachusetts: Harvard University Press, 2001).

⁶²¹ Derek Bok, “Universities in the Marketplace: The Commercialization of Higher Education,” (Princeton, New Jersey: Princeton University Press, 2003).

⁶²² ChevronTexaco was omitted due to the merger.

⁶²³ Clark Kerr, “The Uses of the University,” (Harvard, Massachusetts: Harvard University Press, 2001).



high status that one acquires by graduating from a selective college is very valuable, and students and parents seek out these institutions. By giving the best students an incentive to concentrate at selective colleges, this further delays adjustments to reputations. Moreover, this status good feature of higher education implies that a college's reputation is based largely on the students it attracts rather than the education it provides.

Some Bad Implications for Higher Education

While it is clear that competition in higher education is based on reputations rather than value, and that reputations within the industry are particularly problematic, to get a feel for just how unsatisfactory this state of affairs is, some of the more pernicious implications will be discussed below.

Price as a Proxy for Quality Encourages Higher Tuition

As we saw before, peer effects, by establishing a positive feedback mechanism, create a multiplier for improvements in quality. Caroline M. Hoxby notes that “since a quality competitor can take advantage of the multiplier but a price competitor cannot, the existence of the multiplier makes it difficult for price competition to displace quality competition.”⁶²⁴ With uncertain quality, a perverse tendency to use price as a proxy for quality has developed. Higher priced schools are perceived as offering a better education than lower priced ones. The mentality is that if other students and parents are willing to pay \$30-\$50 thousand to attend a school, it must be worth it. Lowering your tuition sends a signal that you're cutting corners when it comes to educating students, whereas raising tuition sends a signal that you're improving the educational experience.

The most important implication of the tendency to use price as a proxy for quality is that it completely reverses the typical competitive pressure to keep price low. Normally, a higher price will repel consumers, but in higher education, since there is no data on true quality to inform decisions, a higher price attracts them, because it is viewed as a signal of high quality. This tendency to equate price with quality is damaging in that it both rewards universities and colleges for raising tuition as well as punishes them when they cut tuition.

For example, schools can benefit from increasing their sticker price, even if they end up giving their students discounts that offset the entire increase. Miami University (OH) believed that its tuition did not reflect the real value of a Miami degree. So starting in the 2004-2005 school year, it decided to charge all in-state students the out-of-state tuition rate, but give them all an automatic grant for being Ohio residents that would offset this increase. In other words, there was very little difference in the tuition paid by in-state students from what they would have paid in the absence of the change, but on paper, tuition more than doubled from about \$8,500

⁶²⁴ Caroline Hoxby, “How the Changing Market Structure of U.S. Higher Education Explains College Tuition,” NBER paper 6323, 1997.



to about \$19,500. The school was rewarded with an 8% increase in applications that year. This violation of the law of demand, typically punishable in other industries by the latter part of creative destruction, is quite common in higher education.

Similarly, schools that consider cutting tuition face the risk of being seen in a negative light. The California Institute of Technology has a large per student endowment and receives massive federal research grants. As such, tuition revenue is not a very important source of income for the school. This enabled the schools' trustees to consider eliminating tuition for all students. Unfortunately, they decided against it when one trustee apparently warned "This is America: people believe you get what you pay for. [Eliminate tuition], and you will denigrate your value in the marketplace."⁶²⁵ Tuition was not eliminated.

Costs are Driven Higher in a Wasteful Academic Arms Race

As Tim Harford puts it, "As long as [students] have no way to demand better value instead of simply better [perceived] quality, cost inflation seems inescapable."⁶²⁶ Because colleges and universities cannot compete with each other by showing that their students learn more, they compete on reputation instead. With the output side of the equation being universally overlooked, the focus is on inputs. Schools seek high quality inputs because that makes them appear prestigious, which improves their reputation. Thus most of the actual competition that we witness is a fight over the best inputs, evidenced by the growth in merit scholarships awarded to wealthy students who score highly on standardized tests, the poaching of prize winning faculty from other schools, a construction frenzy of new state of the art buildings, the recruitment of star athletes that help win championships, etc.

Not surprisingly, most of the things that will improve a school's reputation cost money, meaning that it is always in a school's interests to spend more. The end result is that institutions are engaged in an academic arms race, with the winner being the one who spends the most money. Since an arms race is a positional struggle for which there is no predetermined end, this implies that from the perspective of colleges and universities, there will never be enough money. Thus, it is not surprising that colleges and universities have been described as "cookie monsters," "compulsive gamblers," and "exiled royalty" - their need for more money is insatiable.⁶²⁷

⁶²⁵ Daniel Golden, *The Price of Admission*, (New York: Three Rivers Press, 2006).

⁶²⁶ Tim Harford, "A Brilliant (and Doomed) Template for Healthcare Reform," *Financial Times*, 17 October 2009. Note that Harford was talking about healthcare, and referred to patients instead of students. Nevertheless, the central insight concerning cost inflation, value, and quality, is applicable.

⁶²⁷ The first one is from Ronald Ehrenberg, the others from Derek Bok.



Funding is Not Necessarily Spent Appropriately

While the academic arms race described in the previous section may not sound that bad at first – spending more on education seems desirable - the problem is that because we do not know what the learning outcomes are, the pursuit of excellence has little to do with increasing learning and everything to do with increasing reputation. When these do not coincide, we have no reason to believe that learning will take priority over reputation. As a former president of an Ivy League school noted, “Presidents and deans do not necessarily allocate funds to achieve the greatest educational results... Often, they act to enhance their institution’s visibility and prestige, which may not always be the same thing.”⁶²⁸

The contrast with value-based competition is striking. When competition is based on value, additional expenditures are subject to cost-benefit considerations. Actions that raise costs (and therefore price) will only be undertaken when they result in greater benefits in terms of value created for customers, but in the reputation-based world, where price is used as a signal of quality, this restraining consideration is absent. It is a given that they will spend as much as they can because they face incentives that reward them for spending as much as possible. This does not imply that colleges and universities do not put any thought into how they spend their money. What it means is that they never ask, “Should we spend this money at all?”

Because all available money will be spent, the actual allocation of spending is determined by benefit-benefit considerations – the proposal with the highest expected benefit will, in theory, get the money. There are two big problems with this. First, in practical terms, because of the paucity of data on the expected benefits of many ideas, the principal-agent problem, and the natural human bias to overestimate the importance of one’s own area, budget allocations are largely determined by the most powerful internal constituents (trustees, administrators, faculty, specific departments, etc.). This means that resources will not always go towards the uses with the highest benefits but to those with the most power on campus.

Second, even if money does go to where it has the most benefit, because the cost side has been largely taken out of the equation, we still cannot be sure that it was the optimal thing to do. At some point, the benefits of more spending will not compensate for their costs. When competition is based on value, we can expect spending to cease at that point, because value takes costs into consideration. However, when competition is based on reputation, costs are not taken into consideration, and we have no reason to expect that spending will stop even if costs are greater than benefits.

In other words, the lack of knowledge about learning outcomes renders determining benefits of proposed changes difficult. In addition, because all available money will be spent, the cost of a program is not of great concern (if the money is not spent here it will be spent elsewhere) - it

⁶²⁸ Derek Bok, *Universities in the Marketplace: The Commercialization of Higher Education*, (Princeton, New Jersey: Princeton University Press, 2003).



matters only to the extent that the funds used cannot be spent on someone else's pet project. Obviously, with an ignored cost side, and a murky benefit side, the whole concept of cost-benefit analysis is neutered. Without cost-benefit analysis to guide spending decisions, we should not be surprised by the many objectionable ways that colleges and universities have found to spend students, parents, and taxpayer money.

Innovation is Stifled

As Burck Smith has noted "every successful technology innovation in the history of humankind has enabled people to do more with less. Education should be no exception."⁶²⁹ Unfortunately it is. One of the most harmful effects of the absence of reliable information on college quality is that innovation is discouraged, and when it occurs, it does not spread.

With reputation-based competition, schools are perpetually trying to move up the status ladder. Those schools at the top, the oldest and richest schools, set the goalposts for everyone else. The top schools have little incentive to innovate – why change when the status quo says you are the best? As a result, they tend to do things in traditional (because they are old and have always done them that way) and expensive (because they are rich) ways, and since they set the standards for the industry, all other methods are immediately suspect. Higher education is perhaps the only industry where those that want to try doing new and innovative things in an inexpensive way are at a distinct disadvantage even after the new way has proven successful.

Nevertheless, higher education is filled with intelligent, caring, and curious people, so improvements to educational practices are made. Yet, as Kevin Carey notes, "Best practices have never been widely adopted because the current rankings and status hierarchy offer no incentives for institutions to seek them out. The lack of good ideas successfully implemented in higher education is not a problem of supply; it's a problem of demand."⁶³⁰

Actually, it is even worse than Carey states. It's not just that institutions don't have incentives to seek out best practices, they have an incentive not to seek them out. If a school goes to the trouble of determining best practices, they will be expected to adopt them. But adopting newer, better programs and policies typically involves discontinuing worse ones. This is problematic because, as Robert Martin points out, "faculty members fiercely resist attempts to end programs... This resistance causes controversy, and administrators and trustees tend to avoid controversies because of their [negative] impact on reputation."⁶³¹

If making the hard choices and upsetting some on campus will not yield demonstrably better outcomes, why not take the path of least resistance and give in to the most powerful internal

⁶²⁹ Burck Smith, "Outside Help: Improving Productivity in Schools," *Threshold Magazine*, Spring 2006.

⁶³⁰ Kevin Carey, "College Rankings Reformed: The Case for a New Order in Higher Education," Education Sector Report, September 2006.

⁶³¹ Robert Martin, "The Revenue to Cost Spiral in Higher Education," John William Pope Center for Higher Education Policy, July 2009.



constituents? This is precisely what happens, and unfortunately, only infrequently do best educational practices and the desires of the most powerful internal constituents align.

Summing Up

Higher education suffers from a number of relatively unique characteristics that fundamentally alter the nature of competition within the sector. The normal competitive pressure to cut costs and improve quality is replaced by an intense pressure to spend more in the pursuit of excellence. This results in a number of bad outcomes. In particular, it leads to the following:

- higher tuition (because tuition is used as a proxy for quality);
- higher spending (because higher spending is the only way to improve your relative reputation);
- inappropriate spending (because cost benefit analysis cannot guide decisions);
- lack of innovation (because there is little incentive for it).

What to Do About It

As should be blindingly clear from the previous sections, the current state of competition based on reputations is highly undesirable. “All too often, the results are expensive, bad decisions”⁶³² by both students and institutions. The solution for this is to get competition to be based on value instead of reputation. For value-based competition, we need reliable information on two things, price and quality. Once this information is available, students can make informed decisions that trade off the two just like we do for everything else we buy and sell.

The good news is that the first of these, price (including net price), is relatively easy to do, and is in the process of being done already. Schools know what this number is, and are currently required to provide enough information to the Department of Education that estimates of an average can be made. While averages are useful, we really need estimates that take into account the specific characteristics of students. With this in mind, Congress mandated that every college have a “net price calculator” on their website by 2011. Some schools, such as MIT, Princeton, Yale, Williams College, and Amherst College have already unveiled theirs.⁶³³ Thus, significant progress has been made on the first requirement.

The bad news is that the other requirement for value-based competition, information on quality, is fiendishly difficult to procure. But it is not impossible. To begin with, faculty already evaluate student learning in their individual courses. “If faculties are willing to examine their students and record the results on official transcripts, it is hard for them to argue that they are

⁶³² William Henderson and Andrew Morris, “What Law School Rankings Don’t Say About Costly Choices,” The National Law Journal, 16 April 2008.

⁶³³ Beckie Supiano, “2 Colleges Share How They Created Net-Price Calculators,” Chronicle of Higher Education, 15 July 2009.



incapable of devising methods of assessment reliable enough to evaluate the effects of their teaching on student learning.”⁶³⁴ Moreover, the profession is already acclimated to using subjective ways of measuring value added contributions of some of their activities, namely research. Enormous resources have been devoted to this task, greatly improving the quality of research as well as hiring and tenure decisions. Given the apparent success of the academy in evaluating research, we could expect similar progress if sufficient effort was made in the realm of student learning. Lastly, “Institutions are already required to report learning outcomes to accrediting agencies.” The downside is that “the depth and breadth of assessments vary, and assessment outcomes are neither available to students nor collected in a way allowing comparison across institutions.”⁶³⁵ While some projects that make information publicly available, such as Voluntary System of Accountability, and U-CAN, are getting off the ground, a recent report

“reveals serious flaws that undermine their utility as engines of accountability... [U-CAN] does not obligate institutions to gather or reveal any data that are not already available elsewhere... As such, U-CAN does little to improve transparency and will be hard-pressed to equip consumers to make more informed choices... [VSA] is more promising... [It] has the potential to provide consumers with important information about costs and quality... But in the case of the VSA, its creators have made conscious decisions about what data to include and how to include it that often serve to inhibit easy comparisons across institutions.”⁶³⁶

While we certainly do not know what the measures of quality should be, given the preceding discussion, they should satisfy several key requirements. First, they should be a measure of value added learning, or at least allow for such determinations to be made. Second, to enable direct comparisons, they must be standardized across schools (i.e., the evaluation to determine how much calculus students learned should be the same or very similar). Third, the results need to be made public and in an easily digestible manner so that potential students can use the information to make informed decisions, and so that schools face pressure to improve.

If such measures were available, the impact on higher education would be nothing short of revolutionary. “Instead of being forced to model themselves after a few elite institutions in a futile attempt to climb the greased pole that is the reigning status hierarchy in higher education, institutions could distinguish themselves for being good at what they were meant to be—educators of undergraduate students... Instead of focusing single-mindedly on raising and

⁶³⁴ Derek Bok, Our Underachieving Colleges: A Candid Look at How Much Students Learn and Why They Should be Learning More, (Princeton, New Jersey: Princeton University Press, 2006).

⁶³⁵ Sara Goldrick-Rab and Josipa Roksa, “A Federal Agenda for Promoting Student Success and Degree Completion,” Center for American Progress, August 2008.

⁶³⁶ Andrew Kelly and Chad Aldeman, “False Fronts? Behind Higher Education’s Voluntary Accountability Systems,” Education Sector Report, March 2010.



spending more money, institutions would focus on using money effectively to improve academic, career, and life outcomes for students.”⁶³⁷

Obstacles to Value Added Measures of Learning

There are two major obstacles to the emergence of value added learning measures. The first is the common objection that no measure of learning would be perfect. While this is certainly true, it is also utterly misguided. Such measures do not have to be perfect to be useful. For example, few scholars would argue that our current peer review processes for evaluating research is perfect, but even fewer would insist that we cease all efforts to evaluate research because of it. In the words of Derek Bok, “to be sure, adequate measures are not available for all subjects, and efforts to use inadequate instruments may trivialize important subjects. Nevertheless, satisfactory methods of assessment seem feasible for a number of subjects... or even for entire fields of concentration.”⁶³⁸

The second obstacle is the interests of the main winners under the current system. As described by Kevin Carey:

Unfortunately, the best interests of most higher education institutions are being held hostage to the interests of a few, particularly elite and private institutions. These highly-esteemed universities occupy one of the most advantaged market positions imaginable... While demand for their product is consistently rising, opportunities for new competitors to enter the market and meet that demand are virtually nil, allowing them to raise prices with near-impunity every year. Their reputation as the world’s best education institutions is virtually unquestioned by the general public, which sees them as both symbols of society’s best values and portals to economic and social opportunity.

They are, in other words, institutions whose best interests lie in using whatever means necessary to prevent the release of any information that would upset the status quo or call their privileged position into question... When the conventional wisdom says you’re the best, you have no interest in proving otherwise.⁶³⁹

Elite institutions are the biggest winners of the reputation-based world, and the only thing that could lead to their downfall is information that calls their quality into question. Even if the elite schools tend to do a good job, if it is revealed that other schools do an equally good job for dramatically less money, this could prove devastating. It should come as no surprise that such schools are terrified of value added measurement. One institution is reported as saying “Stop

⁶³⁷ Kevin Carey, “College Rankings Reformed: The Case for a New Order in Higher Education,” Education Sector Report, September 2006.

⁶³⁸ Derek Bok, *Universities in the Marketplace: The Commercialization of Higher Education*, (Princeton, New Jersey: Princeton University Press, 2003).

⁶³⁹ Kevin Carey, “College Rankings Reformed: The Case for a New Order in Higher Education,” Education Sector Report, September 2006.



gathering the numbers at a central place where they are potentially vulnerable to a freedom-of-information request.”⁶⁴⁰

Unfortunately, the elite schools are in a position to prevent the voluntary adoption of value added measures, since they would have no reason to agree to adopt them – at best they would prove that they are indeed elite, and at worst, it would show that they don’t deserve to be. In effect, the main beneficiaries of an inferior system have veto power when it comes to changing that system. Predictably, we have been stuck in an inferior system and have little hope of escaping it if we continue to rely on voluntary reform from within the academy.

Conclusion

While higher education is intensely competitive, the outcomes resulting from this pressure are far from desirable. “A major reason why competition does not yield optimal results in higher education is that students cannot adequately evaluate the options available to them.”⁶⁴¹ The reason they cannot evaluate their options is that there is virtually no information available about the quality of teaching or how much they can expect to learn. Without this information, students are forced to rely on reputation, which in turn encourages institutions to focus their efforts on improving their reputation, as opposed to their teaching. Not surprisingly, this leads to some highly undesirable outcomes as “behavior is distorted by an information-starved market, where institutional quality stagnates due to lack of competitive pressure to improve vital areas like teaching, where innovators are ignored at best and stifled at worst, where public investment is diminishing by the year due in significant part to a lack of information—and thus, confidence—in what the public receives in return.”⁶⁴²

It does not have to be this way. If information about the true quality of teaching and learning was available, competition would be based on value rather than reputation, and the difference between them is striking. With value-based competition, the invisible hand can be thought of as being attached to a benevolent planner who sees the desires and capabilities of everyone and gently guides them towards the best achievable outcome. In contrast, with reputation-based competition, the invisible hand is attached to a blind man that latches onto the first thing he feels, refusing to let go, freezing the current situation into a perpetual status quo in the process.

To get a feel for just how dysfunctional the market in higher education is, consider what our verdict would be for a car market that functioned in the following way. Mercedes, one of the oldest car manufacturers, is by that right the established leader in the industry. All other cars

⁶⁴⁰ Quote from an institution of higher education as reported in Kevin Carey, “Blocking Public Comparisons Obstructs Knowledge, Too,” *The Chronicle of Higher Education*, February 20, 2009.

⁶⁴¹ Derek Bok, *Universities in the Marketplace: The Commercialization of Higher Education*, (Princeton, New Jersey: Princeton University Press, 2003).

⁶⁴² Kevin Carey, “College Rankings Reformed: The Case for a New Order in Higher Education,” Education Sector Report, September 2006.



are judged by how closely they resemble a Mercedes. When consumers go out to buy a car, all they are told is how close these alternatives are to a Mercedes. Note that no information about Mercedes themselves is available – everyone just knows intuitively that they are the gold standard. In other words, all cars are analyzed based on a standard that is undefined. It is quite clear that not only would consumers not have sufficient information to make informed decisions, but we would have skewed the decisions of all cars manufacturers as well. They would be frantically trying to mimic every aspect of Mercedes instead of making improvements to the design, safety, fuel economy, cost, reliability, and any other number of things that matter to consumers.

We would rightly be shocked to observe such a dysfunctional market for cars, and yet this hypothetical market for cars bears a striking resemblance to the higher education market. Yet many continue to deny that there is even a problem in higher education. Mercedes and Ivy League educations are both great (presumably), but we simply can't afford to provide one to everyone. With differences in preferences and budget constraints, we are made much better off by having a variety of choices available. Just as we would be worse off if we restrict consumers choices to variations of Mercedes, and encourage car manufactures like Kia, Toyota, and Ford to mimic Mercedes, we are not better off encouraging every student to attend elite universities, nor by encouraging every college to mimic them.

As it currently stands, “Improving educational quality is a fundamentally optional goal for colleges. That won't change until institutional reputations are primarily based on how well they educate students.”⁶⁴³ That won't happen until we move away from the harmful reputation-based competition that we currently see, and towards the more socially desirable value-based competition. To make that transition, we need information about the true quality of teaching and learning.

⁶⁴³ Kevin Carey, “College Rankings Reformed: The Case for a New Order in Higher Education,” Education Sector Report, September 2006.

