Glossary

Academic ratchet – new activities in higher education add to permanently higher costs and to a commitment to fund increases in those activities in the future; the costs ratchet up and never come back down through the abandonment of obsolete activities.

Adverse selection – when information is not symmetrically distributed (asymmetric information), market prices can adversely sort for low quality; high interest rates adversely select for low quality borrowers and the buyer's lack of information about product quality results in a premium being paid to low quality providers and discounts below cost for high quality products. This drives the high quality product out of the market; it adversely selects for low quality products.

Asymmetric information – when the information available to each party in a transaction is not uniform, one or more parties in the transaction has more information than the other parties. The more informed party has an economic advantage.

Bundling – combining multiple goods or services and selling them as a package. Bundling products/services reduces customer choice, enables price discrimination, and acts as a barrier to entry for firms that cannot bundle products. Bundling can have a positive social impact when there are economies in production or consumption.

Cash flows – every institution, private, public, or government, has cash inflows and cash outflows that have to be managed in order to avoid chronic unfunded deficits. Managers must resolve differences in the timing of inflows/outflows and insure that debt obligations are met.

Centrifugal randomness – in expenditures and staffing employed among similar higher education institutions. A defined higher education technology would suggest expenditures and staffing would be similar in similar institutions.

Chivas Regal anomaly – the tendency of consumers to associate high quality with high price; occurs only in experience good markets where consumers are uncertain about product quality. Leads to competition to spend more per student among higher education institutions.

Commercialization – the notion that higher education institutions have adopted "business practices." It is a pejorative term that blames quality and cost issues on the outside influence of business interests.

Community service – the third leg on the faculty's "academic stool"; the three component parts of a faculty member's job description are teaching, research, and service.

Contestable markets – a market is said to be contestable when entry/exit costs are at a minimum; for example, an airline's passenger service between Dallas and Denver is easily contested by other airlines that can allocate planes to serve that route and withdraw them at will (entry/exit costs are negligible). The market for highly selective colleges is not contestable; it takes decades to establish a reputation for high quality. When markets are contestable, prices are low regardless of the number of competitors. Therefore, if the airline has a monopoly on the route between Dallas and Denver, the fares will still be low because of the entry threat. If markets are not contestable, prices are high.

Cost disease (generic) – the decades long history of rapidly rising real costs, declining teaching productivity, and resistance to reform in higher education.

(Baumol) – the separation of real wages and productivity in education and the service industries that leads to chronically higher costs.

Credential competition among higher education institutions – selectivity in admissions sends a high quality signal to the labor market for college graduates. The ability to compete on the basis of credentials is empowered by reputation.

De-professionalization among faculty – a decline in professional standing and behavior among faculty members.

Destructuring curriculum – curriculum used to have an internal order to it, where courses were supposed to be taken in a particular sequence and a core body of courses was required; the internal order in curriculum was enforced by faculty advising students; as faculty quit advising students the internal order was abandoned and replaced by an unstructured mixture of courses.

Experience goods – goods whose quality cannot be determined prior to purchase and can only be determined after purchase when consumers have “experience” with the product; it means the consumer must be uncertain about quality prior to purchasing the product.

Facilities competition – the tendency of higher education institutions to invest heavily in physical assets such as classrooms, laboratories, libraries, dormitories, student unions, athletic complexes, and other entertainment facilities. These facilities have become more luxurious and expensive over the last three decades. They represent fixed cost investments in an experience good market that represent “quality” and are also part of the service bundling problem.

Financial burdens in higher education – the increase in education costs that rise as a proportion of median household incomes over the decades. These burdens can be measured by the rate of increase in expenditures per student, the net price of attendance, and the amount of debt students carry upon graduation.

Government mandates – expenditures mandated by governments such as Title IX, students with disabilities, safety, health, and nondiscrimination.

Grade inflation – the secular rise in average grades by program and by institution. As the average grade increases the quality signal conveyed by grades declines and suggests teachers and students have reached some accommodation about grades and teaching evaluations.

Gresham effect – similar to the “lemon effect” where uncertainty about quality tends to drive good quality products out of the market leaving only the low quality products; good products are replaced by “lemons.” See also *Adverse selection*.

Hidden productivity – when outside employers cannot tell how productive a potential employee may actually be.

Information failures – see *Asymmetric information*. Asymmetric information can lead to market failures or situations where transactions society would prefer do not take place.

Inter-industry Gresham effect – as productivity measurement and real wages improve in one industry the industry hires more productive workers and releases low productivity workers; the low productivity workers tend to concentrate in other industries where productivity measurement is not improving, causing productivity to decline in the industries that attract the low productivity workers.

Lemon effects – when consumers cannot differentiate between high and low quality products, a common price prevails (a pooling solution); that price represents a premium for low quality and a discount for high quality. The discount on high quality drives high quality out of the market leaving only the "lemons."

Market for control – if publicly traded for-profit firms do not meet market expectations, they become vulnerable to takeover by outsiders through the market for control; the external threat is a serious constraint on principal/agent problems among for-profit firms.

Media oversight – the role of investigative journalism in preventing principal/agent problems in government, for-profit firms, and nonprofit institutions.

Monopsony power – when an employer is the only employer or the dominant employer in a labor market, the employer has market power with respect to workers in that labor market; the employer can set wage rates and the terms of employment. In legend, this is the "company town" issue.

Moral hazard – since legal agreements are not complete with respect to all possible outcomes, they can create incentives for one party to engage in behavior that is against the interest of the other party to the contract; common in insurance, where the insured person no longer has the incentive to be diligent because he is insured.

Nonprofits – institutions organized to provide public services or private goods to groups who are "underserved" by the private market; since the objective is to expand the quantity of goods/services provided they receive tax exempt status and are expected to be nonprofit.

Pooling solution – when consumers have insufficient information to differentiate between high and low quality products, high and low quality products sell at a common price. The "pooled" price is a weighted average of the proportion of high and low quality products. The pooling solution leads to adverse selection and the lemon effect.

Potential entry – when other institutions/firms are strategically positioned to enter another market they are considered "potential entrants." The threat of entry by outsiders tends to moderate the behavior of existing competitors.

Principal/agent problem – whenever one person (the principal) hires another person (the agent) to make decisions on his behalf there is a potential for a conflict of interest; the agent always has an opportunity to take decisions that benefit his self-interest over the interest of the principal; common in politics, for-profit firms, the medical profession, the legal profession, and, of course, education.

Quality signaling – when quality cannot be readily observed, high quality producers adopt tactics designed to signal quality; the signals must be costly and difficult for low quality producers to mimic. Guarantees and warranties are more costly for low quality producers than high quality producers. Investing in high fixed cost assets whose cost cannot be recovered through any other activity (facilities competition in higher education) acts as a performance bond posted by the producer.

Rents – the economic term "rent" refers to any payment above the opportunity return that would prevail in a competitive solution. When a monopolist earns a profit above the normal profit that would accrue to a competitive firm, that premium is referred to as a "monopoly rent"; when a professional athlete earns a wage greater than his second best employment opportunity, the difference between his athletic salary and his second best salary is a "rent." Rent seeking is a powerful motivating influence in economics.

Reputation competition – the reputation mechanism evolved to address the asymmetric information problems common to experience good markets. High quality providers build reputation by exceeding expectations (supplying high quality products at lower prices than would be expected). The cumulative excess of cost over price is the producer's investment in reputation; in an efficient experience good market, the producer can maintain his reputation only by providing quality commensurate with the price.

Reservation prices – a consumer's reservation price is the highest price he is willing to pay for a product. The market demand curve can be interpreted as a schedule of consumer reservation prices.

Seniority/wage profile – in most labor markets, workers receive a positive real wage differential the longer they work for the same employer; in higher education, faculty earn lower real wages the longer they work for the same employer. Among faculty members, this is known as the “salary compression problem.”

Separating solution – when buyers in experience good markets have enough information to distinguish between high and low quality products the market establishes separate prices for high quality and low quality. More quality information leads to an efficient solution that eliminates the lemon problem caused by pooling solutions.

Strategic decisions – the decisions taken by management that determine the institution’s ultimate future, either prosperity or bankruptcy. At any point in time, current management is either enabled or burdened by the strategic decisions taken by past management.

Third party payers – most market transactions involve two parties, a buyer and a seller. When there are only two parties, each party has the maximum incentive to extract the best possible outcome from the transaction. Third party payers arise when the buyer’s purchase is partially subsidized by others. In this case, the buyer has less incentive to extract the best possible outcome from the transaction and the third party payer is not in a position to determine whether value was received for payment rendered, so the seller is subject to less oversight from the other parties in the transaction.