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ECONOMIC SCENE

Intense Competition for Top Students Is Threatening Financial Aid Based on Need

By ROBERT H. FRANK

CONSIDER the awkward decision confronting the admissions director of a highly selective university that is trying to move forward in the academic pecking order (one of, say, 50 institutions that would have landed in the top 10 this year, except for various flaws in the rankings formula).

On the director's desk sit the folders for two applicants. They have almost the same credentials, but one is just a little better than the other. She has a 4.2 grade point average, the other just a 4.0. She attained a combined score of 1580 on her SAT's, the other only 1440. Her family has an annual income of $500,000, the other's only $30,000.

Emile Wamsteker/Bloomberg News

Many more candidates are applying to prestigious universities like Princeton.

Now, as in the past, both students would be admitted. Years ago, the financial aid packages for these students would have been tailored in a way that would strike most people as just: the low-income student would have received a large aid package and the high-income student no aid at all. And both would probably have enrolled.

No longer. Now, the slightly better-qualified student is likely to be lured elsewhere unless the director can match the substantial merit scholarships she has been offered by other institutions.

But coming up with extra money for her means having to offer a much smaller aid package to the slightly less well-qualified applicant, notwithstanding her family's economic need. In brief, universities' traditional commitment to need-based financial aid is under siege.

Why this change? In large part, it is a result of the sharp growth in the economic rewards of having a degree from an elite institution.

The steep rise in overall earnings inequality over the last three decades has occurred in virtually every industry and occupation.

Even among entry-level jobs, a handful of elite positions now pay several times as much as the average job in each category. Competition for these jobs is fierce. For every starting analyst's position posted by J. P. Morgan, for example, the firm receives mail sacks full of applications. Employers in this situation seldom find time to interview applicants who did not graduate from an elite university.

Ambitious high school students have responded by applying in record numbers to the nation's most selective universities. But there is no greater number of slots in these institutions than before.

And as the many thousands of highly qualified applicants whose rejection letters arrived two weeks ago can attest, the admissions hurdle at top universities has become all but insurmountable. Some now reject 10 or more applicants for each one they accept.

If so many highly qualified students are clamoring for admission to the best universities, why do these institutions feel such pressure to offer merit aid?

The answer is that they need top students every bit as much as top students need them. Indeed, several popular national rankings formulas are based in part on the average SAT score of a university's entering freshmen. So, to lay credible claim to elite status, a university must attract not only a renowned faculty, but also the top-scoring freshmen each year.

To lure such students, other top students are often the most effective bait. Thus, according to one study, applicants typically seek an institution whose average combined SAT score is roughly 100 points higher than their own.

The ideal university, it seems, has much in common with Garrison Keillor's mythical Lake Wobegon, where "all the children are above average."

With median SAT scores in the nation's elite institutions rising steadily over time, bidding for superstar applicants has intensified accordingly.

In short, top-scoring students are an asset whose value has been appreciating more rapidly than Manhattan real estate.

If success in attracting these students tends to be self-reinforcing, so does failure. Losing even a few of them to a rival university can set off a downward spiral, making a university less attractive not only to other top students, but also to distinguished faculty who prefer working with such students.

Institutions aspiring to elite status thus have little choice but to bid aggressively for top-scoring students. And hence the growing tendency for merit-based financial aid to displace need-based financial aid.

Many elite institutions were once party to an agreement in which they pledged to direct their limited financial aid money toward students with the greatest financial needs.

The Justice Department, animated by its belief that unbridled competition always and everywhere leads to the best outcome, took a dim view of this agreement. In 1991, it charged an alliance of 23 elite universities with violating the Sherman Antitrust Act by agreeing not to compete with merit-based financial aid packages for students admitted to more than one member institution.

In response, 22 institutions pledged to end their cooperation on financial aid decisions. (That the Massachusetts Institute of Technology refused to sign the pledge had little practical impact, since it could not continue to collude on aid packages without its former partners.)

The Justice Department was literally correct, of course, that the agreement was anticompetitive. Its explicit purpose was to preserve need-based financial aid by curbing competition for students with star credentials.

But why was that a bad thing? As economists since Adam Smith have persuasively argued, competition often generates enormous economic benefits, but not always. When reward depends strongly on rank, as in higher education, behavior that looks attractive to each institution often proves self-defeating from the perspective of society as a whole.

In such situations, collusive agreements can create gains for everyone. Of course, such agreements can also cause harm, as in the notorious price-fixing cases of antitrust lore. The challenge is to make informed distinctions.

Antitrust authorities may want to reconsider their belief that unlimited competition leads to the greatest good in every situation. Collective agreements should be scrutinized not on quasi-religious grounds, but according to the practical test of whether they limit the harmful effects of competition without compromising its many benefits. The collective agreement among universities to protect need-based financial aid was one that clearly met that test.

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