

Equilibrium Tuition, Applications, Admissions and Enrollment in the College Market

University of Wisconsin–Madison

Author: Chao Fu (JPE,2014)

Pre by: Dongsheng DENG



復旦大學經濟學院
SCHOOL OF ECONOMICS FUDAN UNIVERSITY

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About Chao Fu



Figure: Chao Fu on SSSI 2015, Beijing

Research Fields: Labor Economics, Empirical Microeconomics, Applied Theory

Publications

- *College-Major Choice to College-then-Major Choice*. The Review of Economic Studies (2015).
- *Equilibrium tuition, applications, admissions, and enrollment in the college market*. Journal of Political Economy (2014).
- *Training, search and wage dispersion*. Review of Economic Dynamics (2011).
- *Assumptions Matter: Model Uncertainty and the Deterrent Effect of Capital Punishment*. The American Economic Review (2012).
- *Capital Punishment and Deterrence: Understanding Disparate Results*. Journal of Quantitative Criminology (2013).

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Introduction

The level of college enrollment and the composition of college students continue to be issues of widespread scholarly interest as well as the source of much public policy debate.

- Develop and structurally estimate an equilibrium model of the college market.
- Provides insights into the determination of the population of college enrollees and permits quantitative evaluation of the effects of counterfactual experiments.
- Provides a mechanism for assessing the market equilibrium consequences of changes in government policies.

Related Literature

- **Manski and Wise** (1983) use a non-structural approach to study each stage of the college admissions problem in isolation.
- **Arcidiacono** (2005) estimates a structural model to address the effects of college admissions and financial aid rules on future earnings.
- **Epple, Romano and Sieg** (2006): differ in family income and ability, with complete information, no uncertainty and no unobserved heterogeneity.
- **Chade, Lewis and Simith** (2011): model the decentralized matching of students and two colleges.
- Estimation models with multiple equilibria: Aguirregabiria and Mira (2007) and Bajari, Benkard and Levin (2007) in dynamic games and Bajari, Hong, Krainer and Nekipelov (2010) in static games use a two-step estimation procedure.
- This paper: **Moro** (2003) two-step estimation strategy.

Departures from ERS

- 1 The college market is subject to **information frictions** and **uncertainty**: colleges can only observe noisy measures of student ability, and they do not observe student preferences.
- 2 Student application decisions **differ substantially**.
- 3 This paper models the **strategic behavior** of both *public* colleges and *private* colleges.
- 4 Students have **different abilities and preferences** for colleges, which are unobservable to researchers.

Building on Work by CLS

- Quantifies the significance of the two key elements of CLS: **information frictions** and **application costs**.
- Extend CLS to account for some elements that are important
 - students are *heterogeneous in preferences and abilities*, both of which are unknown to the colleges.
 - allow for two *noisy measures of student ability* (signal + test score).
 - model *multiple colleges* competing via tuition and admission policies.

Advances

This paper makes **advances** relative to the current literature by simultaneously modeling three aspects of the college market:

- 1 Application is *costly* to the student.
- 2 Students differ in their *abilities* and *preferences* for colleges.
- 3 While trying to attract and select more able students, colleges can only observe *noisy measures* of student ability.

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Players: Students

- a continuum of students;
- make application and enrollment decisions;
- come from different family backgrounds (B);
- home state location $l \in B$;
- differ in abilities (measure: $SAT = 1, 2, 3$);
- different preferences for colleges.

Players: Colleges

- J four-year colleges ($j = 1, 2, \dots, J$);
- 1 two-year community college ($j = J + 1$);
- consists of a tuition office and an admissions office;
- fixed capacity $\kappa_j > 0$, $\sum_{j=1}^J \kappa_j < 1$;
- student can attend community college without application (exogenous option).

Assumptions

- A1. There are 4 groups (g) of 4-yr colleges: (private, elite), (public, elite), (private, non-elite) and (public, non-elite);
- A2. From a student's point of view, the location of a college matters only up to whether or not it is within her home state.
- A3. All colleges face the same distribution of students (focus on **symmetric equilibrium**).

With these assumptions, the model focuses on the main features of the college market and factors considered by students:

- The within-group competition is more fierce than that across groups.
- Admissions policies & tuition policies are similar among similar colleges.
- (Student side) tuition cost, whether the college is private or public, elite or non-elite, in or out of one's home state.

Application Cost and Financial Aid

- Application is costly to the student, $C(\cdot)$ is non-decreasing function.
- Financial aid depends on the student's family background(B) and SAT via $f_j(B, SAT)$.
- The exact amounts of financial aid remain uncertain, post-application shocks $\eta \in \mathbb{R}^{J+2}$, distributed i.i.d. $N(0, \Omega_\eta)$.
- The realized financial aid for student i is given by

$$f_{ji} = \max\{f_j(B_i, SAT_i) + \eta_{ji}, 0\} \quad \text{for } j = 0, 1, \dots, J + 1.$$

Student Endowment: Ability

- Student is endowed with certain ability and preferences for colleges.
- Abilities and preferences are potentially correlated.
- Students are of different types (K).
- Unobservable types are correlated with SAT and family background (B): $P(K|SAT, B)$.
- A student type K has two dimensions with $K \equiv (A, z)$.
 - A represents student quality(ability), can be low (1), medium (2) or high (3).
 - $z \in \{1, 2\}$ allows for systematic heterogeneity in preferences among students of the same ability.

Student Endowment: Preference

- Each student may have her own idiosyncratic tastes for colleges that are not representative of her type.
- A type- K student i 's preferences for colleges are modeled as a random vector $u_i \equiv \{u_{ji}\}_{j=1}^{J+1}$, with

$$u_{ji} = \bar{u}_{g_j K} + \epsilon_{1g_j i} + \epsilon_{2ji}$$

g_j represents the group college j belongs to.

- Students differ in their (dis)tastes for studying out of their home states: $\xi_i \sim N(\bar{\xi}_K, \sigma_\xi^2)$.
- Given tuition profile $t \equiv \{\{t_{jl}\}_l\}_j$, the ex-post value of attending college j for student i is

$$U_{ji}(t) = (-t_{jl_i} + f_{0i} + f_{ji}) + u_{ji} - I(l_j \neq l_i)\xi_i, \quad (1)$$

College Payoff

- Colleges care about ability of their enrollees & net tuition revenues.
- For a **private** college j , its payoff W_j is

$$W_j = \int (w_{a_i} + m_{1j} \pi_{ji}) dF_j^*(i) + m_{2j} \frac{\Pi_j^2}{N_j} \quad \text{if } j \text{ is private.} \quad (2)$$

w_a is the value of ability $A = a$, with $w_{a+1} > w_a > 0$, $\pi_{ji} \equiv t_j - f_{ji}$ is the net tuition revenue from student i .

- A **public** college may treat in-state students differently from out-of-state students:

$$W_j = \sum_{\iota=0}^1 \left(\int (w_{a_i} + m_{1j\iota} \pi_{ji}) dF_{j\iota}^*(i) + m_{2j\iota} \frac{\Pi_{j\iota}^2}{N_{j\iota}} \right) \quad \text{if } j \text{ is public.} \quad (3)$$

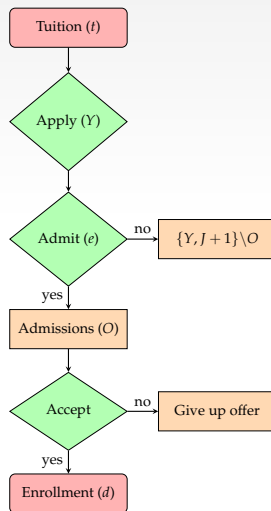
$$\iota \equiv I(l_i = l_j)$$

Timing

Stage 1 : Colleges simultaneously announce tuition levels.

Stage 2 : Students make application decisions; colleges simultaneously choose admissions policies.

Stage 3 : Students learn about admission and financial aid results, and make enrollment decisions.



Information Structure

- Upon student i 's application, each college she applies to receives a signal $s \in \{1, 2, 3\}$ drawn from the distribution $P(s|A_i)$. Signals to various colleges are correlated.
- For $A < A'$, $P(s|A')$ first order stochastically dominates $P(s|A)$.
- Randomness is to capture the idiosyncratic interpretations of the student's application materials.
- Public information: $P(s|A)$, the distributions of characteristics, preferences, payoff functions and financial aid functions.
- Private information: type K_i , taste ϵ_i and family background B_i ($l_i \in B_i$), let $X_i \equiv (K_i, B_i, \epsilon_i)$.

| Information Sets | | | |
|-----------------------|----------------------|------------------------|--------------|
| | Student | Admissions Office j | Researcher |
| Application-Admission | SAT_i, X_i | $SAT_i, s_{ji}, (l_i)$ | SAT_i, B_i |
| Enrollment | SAT_i, X_i, η_i | — | SAT_i, B_i |

Enrollment Decision

- Given her admission and financial aid results, student i chooses the best among her outside option and admissions on hand.
- O_i Denotes the set of colleges that have admitted student i .
- Optimal ex-post value for student i :

$$v(O_i, X_i, \eta_i | t) \equiv \max\{U_{0i}, \{U_{ji}(t)\}_{j \in O_i}\} \quad (4)$$

- Denote the associated optimal enrollment strategy as $d(O_i, X_i, \eta_i | t)$.

Application Decision

- Given her admissions probability $p_i(A_i, SAT_i|t)$ to each college j , the value of portfolio Y for student i is

$$V(Y, X_i, SAT_i|t) \equiv \sum_{O \subset \{Y, J+1\}} \Pr(O|A_i, SAT_i, t) E[v(O, X_i, \eta_i|t)] - C(|Y|) \quad (5)$$

- The expectation is over financial aid shocks, $|Y|$ is the size of portfolio Y . The probability that the set O of colleges admit student i is

$$\Pr(O|A_i, SAT_i, t) = \prod_{j \in O} p_j(A_i, SAT_i|t) \prod_{j' \in \{Y, J+1\} \setminus O} (1 - p_{j'}(A_i, SAT_i|t))$$

- The student's application problem is

$$Y(X_i, SAT_i|t) = \arg \max_{Y \subset \{1, \dots, J\}} \{V(Y, X_i, SAT_i|t)\} \quad (6)$$

Admissions Policy

- Given t , admissions office j chooses its policy subject to κ_j .
- The office treats (s, SAT) with the same policy $e_j(s, SAT|t)$.
- From (s, SAT) , the college has to infer
 - probability of applicant will accept its admission (α_j);
 - expected ability of this applicant conditional on her acceptance (γ_j).
- Given tuition t , students' strategies $Y(\cdot), d(\cdot)$ and other colleges' admission policies e_{-j} , college j solves

$$\begin{aligned} \max_{e_j(s, SAT|t)} \quad & \left\{ \sum_{(s, SAT)} e_j(s, SAT|t) \alpha_j(s, SAT|\cdot) \mu_j(s, SAT|\cdot) \gamma_j(s, SAT|\cdot) \right\} \\ \text{s.t.} \quad & \sum_{(s, SAT)} e_j(s, SAT|\cdot) \alpha_j(s, SAT|\cdot) \mu_j(s, SAT|\cdot) \leq \kappa_j \\ & e_j(s, SAT|t) \in [0, 1] \end{aligned}$$

Probability of Admissions

- The probability of admissions for different (A, SAT) groups of students, $p_j(A, SAT|t)$ summarizes the link among various players.
- Students' application decisions are based on p ;
- p makes the information about admission policy redundant.
- The relationship between p and e is given by

$$p_j(A, SAT|t) = \sum_s P(s|A)e_j(s, SAT|t) \quad (7)$$

- Each application-admission equilibrium is uniquely summarized in the admission prob $p_j(A, SAT)$.

Application-Admission Equilibrium

Application-Admission Equilibrium, $AE(t)$

Given tuition profile t , a symmetric application-admission equilibrium, denoted as $AE(t)$, is $(d(\cdot|t), Y(\cdot|t), e(\cdot|t), p(\cdot|t))$, such that

- (a). $d(O, X, \eta|t)$ is an optimal enrollment decision for every (O, X, η) ;
- (b). Given $p(\cdot|t)$, $Y(X, SAT|t)$ is an optimal college application portfolio for every (X, SAT) , i.e., solves problem (6);
- (c). For every j , given $(d(\cdot|t), Y(\cdot|t), p_{-j}(\cdot|t))$, $e_j(\cdot|t)$ is an optimal admissions policy, and $e_j(\cdot|t) = e_{j'}(\cdot|t)$ if $g_j = g_{j'}$;
- (d). p_j and e_j satisfy (7). (Consistency)

Tuition Policy

- Before the application season begins, college tuition offices simultaneously announce their tuition policies.
- Let $E(W_j|AE(t))$ be college j 's expected payoff under $AE(t)$.
- Given t_{-j} and equilibrium profiles $AE(\cdot)$, college j 's problem is

$$\begin{aligned} \max_{\tilde{t}_{jl} \geq 0} \quad & \{E(W_j|AE(\tilde{t}_j, t_{-j}))\} \\ \text{s.t.} \quad & \tilde{t}_{jl} = \tilde{t}_{jl'} \text{ for all } l \text{ and } l' \text{ if } j \text{ is private,} \\ & \tilde{t}_{jl} = \tilde{t}_{jl'} \text{ for all } l, l' \neq l_j \text{ if } j \text{ is public.} \end{aligned} \tag{8}$$

- Each college considers the strategic role of its tuition in the subsequent $AE(\tilde{t}_j, t_{-j})$,
 - low tuition makes the college more attractive to students and more competitive in the market.
 - high tuition as a screening tool and \Rightarrow a better pool of applicants.

Subgame Perfect Nash Equilibrium

Symmetric Subgame Perfect Nash Equilibrium

A symmetric Subgame Perfect Nash equilibrium for the college market is $(t^*, d(\cdot|\cdot), Y(\cdot|\cdot), e(\cdot|\cdot), p(\cdot|\cdot))$ such that:

- (a). For every t , $(d(\cdot|t), Y(\cdot|t), e(\cdot|t), p(\cdot|t))$ constitutes an $AE(t)$.
- (b). For every j , given t_{-j}^*, t_j^* is optimal for college j , i.e., solves problem (8), and $t_j^* = t_{j'}^*$, if $g_j = g_{j'}$.

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Multiple equilibria

- The estimation is complicated by potential multiple equilibria.
- One way to deal with it: impose some equilibrium selection rule.
- This paper: there is not a single compelling selection rule.
- Building on Moro(2003), this paper use a two-step strategy to estimate the application-admission subgame.
 - ① treats p as parameters and estimates them along with structural student-side parameters.
 - ② one only needs to solve each college's decision problem instead of the game between colleges.

Step 1: Student-Side Parameters and Equilibrium Admissions Probabilities

The author implement the first step via **simulated maximum likelihood estimation (SMLE)**:

- Estimates of the fundamental student-side parameters ($\hat{\Theta}_0$),
 - preference parameters $\hat{\Theta}_{0u}$;
 - application cost parameters $\hat{\Theta}_{0c}$;
 - financial aid parameters $\hat{\Theta}_{0f}$;
 - parameters involved in the distribution of types $\hat{\Theta}_{0K}$.
- Equilibrium admission probabilities \hat{p} should maximize the probability of the observed outcomes of applications, admissions, financial aid and enrollment, conditional on observable student characteristics.

Step 1: Student-Side Parameters and Equilibrium Admissions Probabilities

- Student i is of type K , her contribution to likelihood is composed of
 - $L_{iK}^Y(\Theta_{0u}, \Theta_{0C}, \Theta_{0f}, p)$: the contribution of applications Y_i ;
 - $L_{iK}^O(p)$: the contribution of admissions $O_i|Y_i$;
 - $L_{iK}^f(\Theta_{0f})$: the contribution of financial aid $f_i|O_i$;
 - $L_{iK}^d(\Theta_{0u}, \Theta_{0f})$: the contribution of enrollment $d_i(O_i, f_i)$.

such that

$$L_{iK}(\cdot) = L_{iK}^Y(\cdot)L_{iK}^O(\cdot)L_{iK}^f(\cdot)L_{iK}^d(\cdot)$$

- To obtain the likelihood contribution of student i , integrate over the unobserved type:

$$L_i(\Theta_0, p) = \sum_K P(K|SAT_i, B_i; \Theta_{0K})L_{iK}(\Theta_{0u}, \Theta_{0C}, \Theta_{0f}, p). \quad (9)$$

- The log likelihood for the entire random sample is

$$\mathcal{L}(\Theta_0, p) = \sum_i \ln(L_i(\Theta_0, p)). \quad (10)$$

Test the Existence of Origin-Based Admissions

Two versions of the student decision model are estimated:

- ① $p_j(A, SAT, l)$ depends on $I(l_i = l_j)$;
- ② $p_j(A, SAT, l) = p_j(A, SAT, l')$ for all l, l' .

We can test whether or not admissions depend on a student's origin via a likelihood ratio test, the likelihood ratio test fails to reject the hypothesis that **admissions are origin-independent**.

Specification of the model:

- ① student's origin (l) is not in the admissions office information set.
- ② only ability measures matter for admissions.
 - consistent with the need-blind admissions practiced by a lot of colleges.
 - it significantly facilitates the estimation.

Step Two: Estimate Admission-Related College-Side Parameters

- Use **simulated minimum distance estimation (SMDE)** to recover college-side parameters Θ_2 : signal distribution $P(s|A)$, capacity κ and values of abilities(w).
- Simulate a population of students and obtain their optimal application and enrollment strategies under \hat{p} .
- The resulting equilibrium enrollment in each college group should equal its expected capacity.
- Given \hat{p}_{-j} , college j choose admission policy e_j .
- The estimates of the college-side parameters minimize the weighted sum of the discrepancies.
- Let $\hat{\Theta}_1 = [\hat{\Theta}'_0, \hat{p}']'$, the objective function in Step Two is

$$\min_{\Theta_2} \{q(\hat{\Theta}_1, \Theta_2)' \hat{W} q(\hat{\Theta}_1, \Theta_2)\} \quad (11)$$

Step Three: Tuition Preference

- Under the true tuition preference parameters m , the optimal solution should match the tuition data.
- The objective in Step Three:

$$\min_m \{ (t^* - t(\hat{\Theta}, m))' (t^* - t(\hat{\Theta}, m)) \} \quad (12)$$

- where t^* is the data tuition profile, $t(\cdot)$ consists of each college's optimal tuition;
- $\hat{\Theta} \equiv [\hat{\Theta}_0, \hat{\Theta}_2]$ is the vector of fundamental parameter estimates.

Identification

The identification relies on the following assumptions.

- IA1:** the number of student types is finite; idiosyncratic tastes are separable and independent from type-specific mean preferences; tastes are drawn from an i.i.d. single-mode distribution, with mean normalized to zero, and tastes are independent of (SAT, B, K) .
- The modes of these choices informs one of the number of types and the fraction of each type;
 - distributions of student type-related characteristics will differ around various modes(\Rightarrow one of the correlation between type K and (SAT, y))
- IA2:** At least one variable in the financial aid functions is excluded from the type distribution function; conditional on (SAT, y) ; this variable is independent of K .
- students with the same (SAT, y) may differ in other family background variables that affect their expected financial aid(\Rightarrow different application behaviors).

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NLSY97 Data and Sample Selection

- Respondents from the 1983 and 1984 birth cohorts (administered in years 2003-2005).
- Applied college information (name, location, general financial aid, admission accepted or not, financial aid).
- SAT/ACT score (objective measure of ability).
- Financial-aid-relevant family information (income, assets, race, siblings).
- Focus on first-time college application behavior.
- Exclude early admission + critical info. missing obs (Final: $N = 1646$).

College Groups and Choice Set

- The elite/non-elite division of colleges is based on U.S. News and World Report 2001-2005;
- Top 30 private universities and top 20 liberal arts colleges considered as (private,elite);
- (public, elite) group includes the top 30 public universities;
- Within each of the four groups of 4-yr colleges, a student can send out at most two applications (majority behavior: 83%).

Table 1 Four-Year College Groups

| | (pri,elite) | (pub,elite) | (pri,non) | (pub,non) |
|--|-------------|-------------|-----------|-----------|
| Num. of colleges (Potential ^a) | 51 | 56 | 1921 | 595 |
| Num. of colleges (Applied ^b) | 37 | 56 | 312 | 268 |
| Capacity ^c (%) | 1.0 | 7.7 | 11.5 | 21.9 |

a. Total number of colleges in each group (IPEDS).

b. Number of colleges applied to by some students in the sample.

c. Capacity = Num. of students in the sample enrolled in each group/sample size.

Summary Statistics

Table 2 Student Characteristics

| | Non-Applicants | Applicants | 2-Yr Attendees | 4-Yr Attendees |
|----------------------------|-----------------|-----------------|-----------------|-----------------|
| Female | 43.0% | 53.1% | 47.1% | 53.5% |
| Black | 17.6% | 13.4% | 15.2% | 12.3% |
| Family Income ^a | 39,822 (32,428) | 68,231 (51,208) | 70,605 (51,279) | 70,179 (50,995) |
| $SAT^b = 1$ | 80.2% | 16.6% | 58.0% | 14.0% |
| $SAT = 2$ | 16.7% | 59.7% | 35.8% | 60.3% |
| $SAT = 3$ | 3.1% | 23.7% | 6.2% | 25.7% |
| Observations | 892 | 754 | 374 | 693 |

a. in 2003 dollars, standard deviations are in parentheses.

b. $SAT=1$ if SAT or ACT equivalent is lower than 800 (Obs: 840).⁵⁷

$SAT=2$ if SAT or ACT equivalent is between 800 and 1200 (Obs: 599).

$SAT=3$ if SAT or ACT equivalent is above 1200 (Obs: 207).

Table 3 Number of Applications (%)

| | $n = 0$ | $n = 1$ | $n \geq 2$ |
|--------------|---------|---------|------------|
| All Students | 54.2 | 28.0 | 17.8 |
| $SAT = 1$ | 85.1 | 12.1 | 2.8 |
| $SAT = 2$ | 24.9 | 45.2 | 29.9 |
| $SAT = 3$ | 13.0 | 43.0 | 44.0 |

Summary Statistics

Table 4 Application & Admission: All Applicants

| (%) | (pri,elite) | (pub,elite) | (pri,non) | (pub,non) |
|------------------|-------------|-------------|-----------|-----------|
| Application Rate | 9.7 | 31.8 | 44.6 | 71.5 |
| Admission Rate | 53.4 | 83.0 | 91.4 | 94.0 |
| SAT=3 Enrollees | 93.8 | 36.2 | 27.9 | 17.8 |

Num of all applicants: 754

Application rate=num. of group-specific applications/num. of all applications

Admission rate=num. of group-specific admissions/num. of group-specific applications

Table 5 Tuition and Financial Aid

| | (pri,elite) | (pub,elite) | (pri,non) | (pub,non) | 2-yr College | General |
|---------------------------------|-------------|-------------|-----------|-----------|--------------|---------|
| Tuition ^a (In-State) | 27,033 | 5,000 | 17,296 | 3,969 | 2,744 | — |
| (out-of-state) | | 14,435 | | 10,215 | — | |
| Aid Recipients ^b | 25% | 24.1% | 49.5% | 27.2% | — | 39.9% |
| Average Aid Offered | 12,440 | 6,962 | 11,389 | 5,208 | 3,095 | 4,326 |

a. Tuition and aid are measured in 2003 dollars.

b. Num. of aid offers/num. of admissions in the sample. N/A for 2-yr colleges due to open admissions.

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Student Preferences for Colleges

Table 6 Preferences for Colleges

| (\$1,000) | (pri,elite) | (pub,elite) | (pri,non) | (pub,non) | 2-yr |
|--|----------------|---------------|--------------|--------------|--------------|
| $\bar{u}_g(A=1,z=1)^a$ | -187.7 (188.0) | -183.2 (5.1) | -123.5 (3.8) | -188.6 (4.4) | -38.1 (1.7) |
| $\bar{u}_g(A=2,z=1)$ | -42.2 (66.5) | -37.2 (4.6) | 31.0 (1.4) | 56.8 (2.1) | 36.1 (1.4) |
| $\bar{u}_g(A=3,z=1)$ | -52.8 (21.4) | 127.3 (0.4) | 8.2 (7.6) | 73.2 (3.9) | 9.8 (4.5) |
| $\bar{u}_g(A=2,z=2)$ | -74.4 (29.4) | -115.7 (34.9) | 96.6 (4.6) | 19.4 (3.19) | -13.3 (5.6) |
| $\bar{u}_g(A=3,z=2)$ | 139.9 (14.3) | 30.4 (14.5) | 35.6 (19.5) | -66.2 (16.4) | -12.7 (33.2) |
| $\sigma_{\epsilon_{1g}}^2$ (college group) | 49.9 (8.4) | 24.9 (3.0) | 42.3 (1.0) | 57.4 (1.8) | 61.4 (1.2) |
| $\sigma_{\epsilon_2}^2$ (specific college) | | | 61.5 (1.2) | | |

^a The restriction $\bar{u}_g(A=1,z=2) = \bar{u}_g(A=1,z=1)$ holds at 10% significance level.

- For $A = 1$ (low ability) student, the non-college option is better.
- (Explain) Majority of (low family income, low SAT) students do not apply to or attend any college in the data.
- Middle- A students rank non-elite colleges over elite colleges, while the opposite is true for high- A students.
- $z=1$ type value public and 2-yr colleges over private colleges.
- By introducing types, the model explains the systematic differences in students' choices.

Home Bias V.S. Application Cost

Table 7 Out-of-State Utility Cost

| \$1,000 | (A=3,z=2) | (A<3,z=2) | (A=3,z=1) | (A<3,z=1) |
|---------------------------------------|------------|------------|-----------|-----------|
| Mean ($\bar{\xi}_K$) | 22.5 (1.1) | 26.1 (0.6) | 37.1 | 40.7 |
| $\bar{\xi}(A,z=1) - \bar{\xi}(A,z=2)$ | | 14.6 (0.5) | | |
| Dispersion (σ_{ξ}) | | 35.1 (0.5) | | |

^a The restriction $\bar{\xi}(A=1,z) = \bar{\xi}(A=2,z)$ holds at 10% significance level.

- Cost includes both extra monetary costs such as costs for transportation and residence, as well as psychic cost.
- Lower for high- A students (better at adapting new environment).

Table 8 Application Costs

| \$1,000 | $n = 1$ | $n = 2$ | $n = 3$ | $n \geq 4$ |
|-----------------|------------|-------------|-------------|-------------|
| $C(n) - C(n-1)$ | 1.90 (0.3) | 0.90 (0.05) | 0.33 (0.02) | 0.27 (0.03) |

- Cost: collect information; prepare materials; stress; anxiety.
- Marginal cost rapidly decreases (economy of scale).
- Student ability and preferences are far more important.
- $C \rightarrow 0.5C$, non-applicants fraction remains at 51% (baseline: 54%).

Ability Measures

Table 9.1 SAT and Ability: Simulation

| % | $P(SAT=1 A)$ | $P(SAT=2 A)$ | $P(SAT=3 A)$ |
|-------|--------------|--------------|--------------|
| $A=1$ | 91.0 | 8.3 | 0.7 |
| $A=2$ | 18.3 | 65.8 | 15.9 |
| $A=3$ | 1.5 | 52.4 | 46.1 |

Table 9.2 Signal Distribution

| % | $P(s=1 A)$ | $P(s=2 A)$ | $P(s=3 A)$ |
|-------|------------|------------|------------|
| $A=1$ | 94.1 (0.4) | 1.4 | 4.5 (5.1) |
| $A=2$ | 7.7 (0.5) | 87.8 | 4.6 (2.4) |
| $A=3$ | 0.04 (0.7) | 46.7 | 53.3 (8.8) |

Table 9.3 Family Income and Ability

| % | $P(A \text{Low Inc})$ | $P(A \text{Middle Inc})$ | $P(A \text{High Inc})$ |
|-------|-----------------------|--------------------------|------------------------|
| $A=1$ | 71.8 | 49.8 | 20.8 |
| $A=2$ | 25.1 | 40.2 | 49.6 |
| $A=3$ | 3.1 | 10.0 | 26.7 |

Low Inc: if family income is below 25th percentile (group mean \$10,017)

Middle Inc: if family income is in 25-75th percentile (group mean \$45,611)

High Inc: if family income is above 75th percentile (group mean \$110,068)

- SAT is less useful in distinguishing between medium & high-ability types.
- Family income has substantial influence on forming students' ability as Cameron and Heckman (2001).

Model Fit

Table 10 Model v.s. Data
Num of Applications (%)

| Size | Data | Model |
|---------------|------|-------|
| 0 | 54.2 | 54.5 |
| 1 | 28.0 | 27.8 |
| 2 or more | 17.8 | 17.7 |
| χ^2 Stat | 0.06 | |

$$\chi^2_{2,0.05} = 5.99$$

Table 12 Model v.s. Data
Final Allocation of Students (%)

| | Data | Model |
|----------------|------|-------|
| (pri,elite) | 1.0 | 1.5 |
| (pub,elite) | 7.7 | 8.0 |
| (pri,non) | 11.5 | 10.9 |
| (pub,non) | 21.9 | 20.2 |
| 2-yr college | 22.7 | 22.9 |
| Non-college | 35.2 | 36.5 |
| χ^2 Stat. | 6.98 | |

$$\chi^2_{5,0.05} = 11.07$$

Table 11 Model v.s. Data
Application & Admission: Applicants (%)

| Application Rate | Data | Model |
|------------------|------|-------|
| (pri,elite) | 9.7 | 9.4 |
| (pub,elite) | 31.8 | 29.0 |
| (pri,non) | 44.6 | 44.4 |
| (pub,non) | 71.5 | 67.6 |
| Admission Rate | | |
| (pri,elite) | 53.4 | 58.5 |
| (pub,elite) | 83.0 | 90.1 |
| (pri,non) | 91.4 | 91.5 |
| (pub,non) | 94.0 | 95.9 |

* All Pass $\chi^2_{1,0.05}$ test.

Model Fit

Table 13 Model v.s. Data: Home Bias

| % | Data | Model |
|-----------------------------------|------|-------|
| Home-Only Applicants ^a | 65.6 | 67.5 |
| Home-State Attendees ^b | 76.2 | 78.0 |

* Both pass $\chi^2_{1,0.05}$ test.

^a % students who apply only within home states among all 4-yr applicants.

^b % students who attend home-state 4-yr colleges among all 4-yr attendees.

Table 14 Model v.s. Data: Tuition

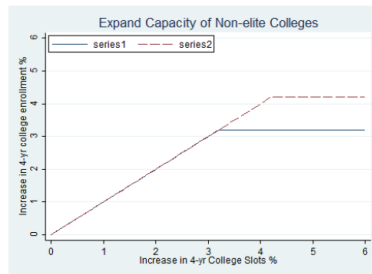
| \$ | (pri,elite) | (pub,elite) | | (pri,non) | (pub,non) | |
|-------|-------------|-------------|--------------|-----------|-----------|--------------|
| | | In-State | Out-of-State | | In-State | Out-of-State |
| Data | 27, 033 | 5, 000 | 14, 435 | 17, 296 | 3, 969 | 10, 215 |
| Model | 27, 530 | 5, 090 | 13, 892 | 16, 891 | 3, 451 | 10, 540 |

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Creating More Opportunities

- To what extent can the government expand college access by increasing college capacities?
 - ① S1: community college tuition is maintained at its current level (\$2,744);
 - ② S2: community colleges become free and the lower bound on 4-yr college tuition is set to zero.
- Under each scenario, I conduct a series of expansion experiments and **increase the capacities of (pub,non) colleges** by growing magnitudes while keeping the capacities of other colleges fixed.



Increasing Supply: Tuition

Table 15.1 Increasing Supply: Tuition

| \$ | (pri,elite) | (pub,elite) | | (pri,non) | (pub,non) | |
|----------|-------------|-------------|--------------|-----------|-----------|--------------|
| | | In-State | Out-of-State | | In-State | Out-of-State |
| Baseline | 27,530 | 5,090 | 13,892 | 16,891 | 3,451 | 10,540 |
| New 1 | 29,152 | 4,177 | 11,568 | 15,291 | 2,744 | 2,744 |
| New 2 | 29,952 | 2,917 | 7,308 | 13,631 | 0 | 18 |

- (public,non) cut their tuition for both in/out state students in order to attract enough students.
- (public,elite) and (private,non) lower their tuition.
- (private,elite) increase their tuition.
 - total slots in these colleges are still scarce.
 - increasing its tuition helps to screen out lower-ability students.

Increasing Supply: Admission

Table 15.2 Increasing Supply: Admissions

| % | (pri,elite) | (pub,elite) | (pri,non) | (pub,non) |
|----------|-------------|-------------|-----------|-----------|
| Baseline | 58.5 | 90.1 | 91.5 | 95.9 |
| New 1 | 63.6 | 90.8 | 92.1 | 100.0 |
| New 2 | 71.8 | 89.8 | 91.3 | 100.0 |

- In both cases, (public,non) admit all the applicants.
- Under S1, admissions rates also increase in all the other colleges.
- Higher admissions rates and lower tuition reflect their efforts to enroll enough students.
- (private,elite) increase because a better self-selected applicant pool.
- Under S2, (public,elite) and (private,non) slightly lower than baseline.

Increasing Supply: Attendance

Table 15.3 Increasing Supply: Attendance

| % | Baseline | New 1 | New 2 | All Open&Free |
|------|----------|-------|-------|---------------|
| 4-Yr | 40.6 | 43.2 | 44.2 | 55.6 |
| 2-Yr | 22.9 | 21.9 | 22.9 | 18.0 |

- Under S1, 4-yr college attendance rate +2.6%, 2-yr college -1%.
- Under S2, 3.6% drawn into 4-yr colleges.
- When all colleges are open and free;
 - 4-yr college attendance rate +15%;
 - 2-yr college attendance rate -5% (most of them choose to stay);
 - Some students (10%) are constrained by tuition and/or available slots.

Increasing Supply: Why Limited Effects

Why expansion has such limited effects on enrollment?

Table 15.4 Increasing Supply: Attendance by Ability

| % | Baseline | New 1 | New 2 | All Open&Free |
|---------|----------|-------|-------|---------------|
| $A = 1$ | | | | |
| 4-Yr | 1.0 | 3.5 | 4.3 | 18.9 |
| 2-Yr | 27.0 | 26.5 | 29.2 | 26.5 |
| $A = 2$ | | | | |
| 4-Yr | 72.3 | 75.1 | 76.7 | 86.9 |
| 2-Yr | 24.0 | 21.9 | 21.1 | 12.7 |
| $A = 3$ | | | | |
| 4-Yr | 93.3 | 94.1 | 94.4 | 97.8 |
| 2-Yr | 5.8 | 5.3 | 5.1 | 2.2 |

- Under baseline, only 28% of low-ability attend any college.
- When free and open, 18% more of them be attracted to colleges.
- Almost all students of higher ability attend colleges, mostly 4-yr ones.

Conclusion: The major barrier to college access is student ability and associated preferences, not college capacity or tuition.

Ignoring Signals: Tuition

- In some countries, college admissions are based almost entirely on scores in a nationwide test.
- In this experiment, try to **assess the consequences of ignoring signals in the admissions process**.
- $e(s, SAT) \Rightarrow e(SAT)$.

Table 16.1 Ignore Signals: Tuition

| \$ | (pri,elite) | (pub,elite) | | (pri,non) | (pub,non) | |
|----------|-------------|-------------|--------------|-----------|-----------|--------------|
| | | In-State | Out-of-State | | In-State | Out-of-State |
| Baseline | 27,530 | 5,090 | 13,892 | 16,891 | 3,451 | 10,540 |
| New | 30,028 | 5,131 | 14,079 | 14,800 | 3,083 | 9,426 |

- Elite colleges draw on higher tuition to screen students when the information on ability is unavailable.
- Non-elite colleges lower their tuition to compete for high-ability applicants rejected by elite colleges.

Ignoring Signals: Application and Admission

Table 16.2 Ignore Signals: Num of Applications

| % | Num = 0 | Num = 1 | Num ≥ 2 |
|----------|---------|---------|--------------|
| Baseline | 54.5 | 27.8 | 17.7 |
| New | 52.7 | 34.2 | 13.1 |

Table 16.3 Ignore Signals: Admission Rates

| % | All | | SAT= 1 | | SAT= 2 | | SAT= 3 | |
|-------------|------|------|--------|------|--------|-------|--------|-------|
| | Base | New | Base | New | Base | New | Base | New |
| (pri,elite) | 58.5 | 66.7 | 22.1 | N/A | 41.3 | 32.9 | 76.2 | 100.0 |
| (pub,elite) | 90.1 | 88.9 | 16.0 | 6.5 | 91.0 | 100.0 | 98.0 | 100.0 |
| (pri,non) | 91.5 | 80.0 | 77.1 | 11.2 | 93.7 | 100.0 | 100.0 | 100.0 |
| (pub,non) | 95.9 | 90.6 | 83.1 | 62.3 | 98.5 | 100.0 | 100.0 | 100.0 |

*N/A: not applicable because of zero applicant.

- In response to tuition reductions, more students apply to colleges;
- Applicants apply less due to less uncertainty (especially true for high-SAT applicants).

Ignoring Signals: % of High-Ability Students

Table 16.4 Ignore Signals: % of High-Ability Students

| % | (pri,top) | (pub,top) | (pri,non) | (pub,non) |
|----------|-----------|-----------|-----------|-----------|
| Baseline | 94.7 | 80.2 | 11.0 | 15.9 |
| New | 86.4 | 79.0 | 12.7 | 16.1 |

- Elite colleges experience a drop in their enrollee ability (less info.).
- The non-elite ones get more high-ability students.

Table 16.5 Ignore Signals: Student Welfare

| \$1,000 | Baseline | New |
|---------|----------|-------|
| All | 67.8 | 67.2 |
| $A = 1$ | 10.4 | 11.3 |
| $A = 2$ | 111.0 | 109.0 |
| $A = 3$ | 150.4 | 148.8 |

- Average student welfare decreases by \$600.
- The non-elite ones get more high-ability students.
- low-ability students gain because colleges find it harder to distinguish.

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Conclusion

- It provides a better understanding of the college market by jointly considering tuition setting, applications, admissions and enrollment.
- Three-step estimation used to cope with multiple equilibria.
- \exists substantial heterogeneity in students' preference for colleges;
- Neither tuition cost nor college capacity is a major obstacle to college access (Expanding college capacities has very limited effects);
- When colleges don't have measure of student ability, elite colleges draw on higher tuition, while non-elite colleges lower their tuition.