

Competing Campuses: An Equilibrium Model of the U.S. Higher Education Market

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## Abstract

Universities compete through price and non-price characteristics, including the number and type of undergraduate majors offered. Undergraduate majors are a key source of differentiation in U.S. higher education, and survey evidence suggests that students consider a university's offered majors when they make their college choice. The objective of this research is to understand how majors offered, prices and selectivity jointly respond to subsidies in the form of financial aid and direct-to-university subsidies to support majors in Engineering, Science, and Mathematics. I use state-level score-sending data from ACT and College Board along with university characteristics to estimate a model that features four stages: first, universities choose price, admission criteria and majors; second, students choose an application portfolio; third, universities make offers of admission; and finally, students make enrollment decisions. The estimates show that students are willing to pay over \$100 per year for each major, with heterogeneity by type of major. Financial aid awarded to students to attend public universities in a state results in increased price and selectivity stratification in the public sector, higher prices and increased selectivity in segments of the private sector, and adjustments to majors offered to manage costs. A \$10 per student subsidy to public universities for each Engineering, Math, and Science major offered generates similar stratification by pricing and selectivity, but also increases the median number of Engineering, Math, and Science majors at public universities from 8 to 12.

JEL Codes: I23, I28, L13, L31

Keywords: College Choice, College Majors, College Admission, Non-profit Objective

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*Soli Deo Gloria.*

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# Chapter 1

## Introduction

Survey evidence suggests that the menu of majors offered at each university is a key determinant of where students apply and enroll. Among students who were high school seniors in 2012, 74.9% indicated that the majors and programs offered would be a very important factor in their college choice.<sup>1</sup> One reason for this is that a student's choice of major may be limited by the selection of majors offered at their university. There are notable differences across universities in the majors that they offer—the average university offers 55 majors and the standard deviation of majors offered is 26.<sup>2</sup>

Recognizing that majors offered may affect student demand, universities compete by choice of prices, selectivity, and the number and type of majors offered.<sup>3</sup> For example, when the University of Wisconsin at Stevens Point (UWSP) proposed to cut

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<sup>1</sup>The survey evidence is from the National Center for Education Statistics' High School Longitudinal Study of 2009.

<sup>2</sup>There are approximately 1,500 undergraduate majors that are classified by the National Center for Education Statistics.

<sup>3</sup>Prices and selectivity are likely some of the most flexible choices of universities, so prices and admissions selectivity are endogenous responses in addition to the number and type of majors.

13 majors (including French, German, history, geology, geography, and art) and add new programs in high-demand majors like environmental science, the provost cited “rising competition among public and private universities” as one of the motivating factors (Strauss, 2018).<sup>4</sup>

This research studies how universities’ prices, admission standards, and majors offered respond to subsidies under the assumption that universities compete in a strategic setting. Foundational to this study is a baseline understanding of universities’ incentives. Thus the first step in this research is to establish the sign and magnitude of the effect of prices, selectivity, and majors offered on demand, conditional on other university characteristics. Given these demand estimates, I then estimate the preferences and costs that drive universities’ choices. Finally, I use these results to study the equilibrium effects of subsidies in the form of financial aid awarded to students and subsidies awarded to universities to support Engineering, Math, and Science programs.

The tool for analysis is an equilibrium model that features four stages: first, universities choose majors, admission criteria, and price; second, high-school seniors observe universities’ choices and exogenous characteristics and choose a set of universities to apply to; third, universities offer admission to a subset of applicants; and finally, students make their enrollment decisions. Modeling the application, admission, and enrollment stages of the process produces college choice parameters that have a meaningful interpretation in an expected utility-maximization framework. Modeling the admissions process also allows me to compute measures of selectivity and enrollment, which then enter the university objective function. This objective function

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<sup>4</sup>UWSP ultimately decided to maintain these majors, saying that they had found other ways to cut costs.



features a trade-off between selectivity and revenue net of costs, with heterogeneous preferences for selectivity. Universities are strategic, an assumption that is consistent with previous research that shows that universities typically have a small number of close competitors, and generally in limited geographic areas.<sup>5</sup>

To estimate the model I use state-level data from ACT and College Board combined with information on universities from the Integrated Postsecondary Education Data System (IPEDS). IPEDS is a set of surveys of the population of universities in the United States and is maintained by the National Center for Education Statistics. These surveys provide information on tuition and financial aid, location, and many other university characteristics. IPEDS also provides enrollment to each university from each state, which I use to construct state-level enrollment shares. The ACT and College Board data show the number of students in each state who sent score reports to each university, which I use as a measure of applications. The application and enrollment data together allow estimation of student preferences. In addition to the state- and university-level data, individual student data from the NCES' High School Longitudinal Study of 2009 (HSL:09) and the Education Longitudinal Study of 2002 (ELS:2002) inform pieces of the estimation procedure.

Relative to previous research on equilibrium in the U.S. higher education market, this paper presents a new estimation method that allows strategic interaction between universities that are differentiated by a variety of exogenous and endogenous characteristics. The estimation method utilizes state-level aggregate data and adapts the traditional approach to estimation of differentiated-products models of oligopoly competition, as in Berry et al. (1995), to this setting. Notable differences between the

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<sup>5</sup>Hoxby (1997) and Smith et al. (2018) both assert that universities compete for students and that universities compete most with universities that are located nearby.

higher education market and a typical consumer product market motivate substantial deviations from the standard model. The institutional details that drive these differences include: 1) universities are not profit maximizing, 2) consumers (students) must apply and be accepted in order to “purchase” the product, and 3) universities charge one price across all markets (with the exception of public universities, which charge an in-state and an out-of-state price). I also deviate from the Berry et al. (1995) model in that I allow multiple endogenous characteristics.

The estimated college choice parameters show that the majors offered by a university affect college choice. My estimates show that students value majors offered at approximately \$136 on average, with substantial heterogeneity by type. Engineering, Math, and Science majors are valued the most, followed by Business and Communications, then Arts, Social Science, and Humanities. On the supply-side, I show that a net-revenue maximizing framework does not fit the behavior of universities.

In the first policy simulation, I consider the effect of increased financial aid offered to students who attend in-state public universities. After a \$1,000 grant is offered to Wisconsin students to attend public universities in their state, public universities become increasingly stratified by admission selectivity and price. Private universities—especially the least selective ones—become more expensive and more selective, as they are less able to attract students with low test scores away from the broad-access public universities. Changes to majors offered allow all universities to adjust their costs, and these changes tend to moderate the effects of the policy on prices and admissions selectivity.

A second policy simulation considers the effect of subsidizing majors offered in Engineering, Math, and Science. When public universities in Wisconsin are offered \$10 per student per major offered in Engineering, Math, and Science, the median

number of Engineering, Math, and Science majors offered at each public university increases from 8 to 12. Again, public universities become more stratified by admission selectivity and price, and the least selective private universities raise their prices and admission standards substantially.

The remaining sections of this paper are as follows: Section 2 describes related research, with a focus on models of college choice and equilibrium in higher education. Section 3 describes the data sources and provides motivating empirical evidence. Section 4 outlines the four-stage model and derives equations that are later used in estimation. Sections 5 and 6 present the identification argument, empirical strategy and resulting model parameters. Section 7 presents the counterfactuals, and Section 8 concludes with a discussion of the results and limitations of this research and areas for future work.

## Chapter 2

# Related Research

This paper combines a college choice (demand-side) model with a model of the supply-side of higher education in the U.S. to understand how prices, selectivity and majors offered respond to subsidies. There is a long literature on the demand-side of the higher education market, as college choice is an especially consequential decision.<sup>1</sup> There is much less work on the supply-side and equilibrium in the U.S. higher education market, likely because this market is difficult to model. Two key features contribute to the difficulty; first, the admissions process is decentralized, and second, the market mixes public and private universities with objectives that (it is generally agreed) include characteristics of their respective student bodies.

In this section, I provide an overview of previous work on college choice and equilibrium in U.S. higher education. There is also a large literature on centralized admissions mechanisms, which is mainly relevant for high school admissions and in higher education systems outside the U.S. I omit a thorough discussion of this work

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<sup>1</sup>College attendance—and the specific college attended and major pursued—have been shown to affect future earnings (Keane and Wolpin, 1997; Card, 1999; Dale and Krueger, 2002; Altonji et al., 2012).

here because it is not immediately relevant to my context. Readers are referred to Hafalir et al. (2018) for a discussion of the literature on centralized and decentralized admissions mechanisms.

## 2.1 College Choice

The college choice process is complex because it involves multiple stages. A student must apply to potentially many colleges, then the colleges make admission decisions, and then the student chooses whether and where to attend. Because this decision process is complex and consequential, a wide variety of methods have been employed to study college choice.

Early literature on college choice, such as the influential book by Manski and Wise (1983), addressed each stage independently. Manski and Wise utilize individual data to characterize each stage of the college choice process conditional on outcomes in the previous stage. Some more recent research also utilizes this approach. For example, Avery and Hoxby (2004) and Long (2004b) examine a student's choice of where to enroll conditional on having been admitted. Avery and Hoxby (2004) focus on the role of financial aid packages, and Long (2004b) studies how the importance of factors like price and distance have changed over time.

Another large and influential line of research uses experimental and quasi-experimental approaches to learn about the college admission process. This work generally analyzes the effects of a randomized treatment or a policy change on application, admission, or enrollment outcomes separately. For example, Hoxby and Turner (2015) and Dynarski et al. (2018) study the role of information and uncertainty in college choice, Pallais (2015), Goodman (2016), and Hyman (2017) study the effect of admis-

sion testing policies on college applications and enrollment, Kane (2003) studies the effect of financial aid on college choice, and Bettinger et al. (2012) study the effect of assistance with submitting applications for federal student aid.

More recent work on affirmative action and related policies, including Arcidiacono (2005), Howell (2010), and Kapor (2016), jointly models the application, admissions, and enrollment stages of the college choice problem. Kapor (2016) also models persistence, while Arcidiacono (2005) models college and major choice and labor market returns. The counterfactual question in each of these papers involves varying the admissions process (either nationally or for a state) and allowing students to change their application and enrollment behavior accordingly.<sup>2</sup>

Fu (2014) also presents a model of applications, admissions, and enrollment. Her model extends previous work by incorporating uncertainty in the admissions process for both students and colleges. Colleges in her model care about student ability, but only observe noisy signals of ability. Her counterfactuals study the effect of increasing college capacity on enrollment, and the effect of basing admission decisions only on test scores.

In each of the papers that model applications, admissions, and enrollment, a student's application decision is modeled as a choice between application portfolios, where the value of an application portfolio depends on the probability of admission

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<sup>2</sup>Bodoh-Creed and Hickman (2018) also study affirmative action with a structural framework, without explicitly modeling the admissions, application and enrollment process. In their model, students compete in a large contest for slots at colleges of different quality by choosing different pre-college human capital investments (in practice, test scores and GPA). The current paper and the others cited in this paragraph take pre-college academic measures as given, but have other strengths relative to the model in Bodoh-Creed and Hickman (2018); importantly, students have heterogeneous preferences for each college and college application is costly. In addition, the current paper has endogenous college characteristics, whereas the model in Bodoh-Creed and Hickman (2018) these are fixed.

and the expected value of enrollment.<sup>3</sup> My college choice model follows the same basic framework, with several key differences. First, enrollment utility is a function of majors offered. Second, the model takes into account the regional nature of markets; students will choose from a set of universities that depends on their location. Third, I utilize aggregate data and a simulated method of moments estimation strategy, which allows me to estimate demand for over 800 individual universities with a rich set of controls for university characteristics. The method is complementary to other methods with individual data, as those methods allow richer controls for individual characteristics.

## 2.2 Supply-Side and Equilibrium

Work on the supply-side and equilibrium in U.S. higher education is a small but growing area of research. The most related research considers setting of equilibrium admissions policies and/or prices.

Related literature on admissions begins with Chade et al. (2014). This paper presents a decentralized admissions model in which two universities compete for the best students by setting an admission threshold, given a fixed capacity. Students are unsure how their application will be perceived by colleges. In this framework, they show that sorting may fail under certain conditions (in the sense that weaker students may apply more aggressively than stronger students, and that high-quality colleges

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<sup>3</sup>A multiple-discrete choice problem arises in the application stage because a student can choose more than one school to apply to at a time. Modeling the application stage as a choice between application portfolios converts the multiple-discrete choice problem to a single-discrete choice problem. This solution has been used in other contexts. For example, Gentzkow (2007) estimates demand for newspapers, where consumers can choose to read more than one newspaper. In his model, consumers choose between “bundles” of the available newspapers. See his paper for a more thorough review of multiple-discrete choice models.

may set lower admission standards than low-quality colleges). Fu (2014) incorporates elements of the Chade et al. (2014) framework, including fixed capacities and uncertain admissions from the student perspective. She also allows that the observed test score is a noisy signal of a student’s true ability. Kapor (2016) also models the choice of admission thresholds, but unlike in Fu (2014), universities perfectly observe the admissions-relevant student characteristics. In each of these papers (as in the current paper), admissions policies are determined by equilibrium behavior of students and universities.<sup>4</sup> My approach to admissions is most similar to Kapor (2016) in that universities observe all student characteristics that are relevant for admissions.

Another strand of literature explores the determinants of prices in higher education. An early theoretical treatment by Rothschild and White (1995) models higher education institutions as competitive profit-maximizing institutions that produce human capital with a technology that depends upon students as inputs. They do not model the admissions process. In their framework, prices exist that efficiently allocate students of multiple types to universities. However, the authors go on to note that empirical pricing patterns do not fit their theoretical predictions. Higher quality universities do not necessarily charge higher prices (at least, not enough higher to absorb the differences in wages received by graduates), and universities typically do not charge different tuition across majors, although different programs are associated with different labor market returns.<sup>5</sup>

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<sup>4</sup>In some college choice models, including Howell (2010) and Arcidiacono (2005), the university’s choice of an admissions policy is not modeled. The admissions policy is assumed to be a given function of exogenous university and student characteristics.

<sup>5</sup>As Rothschild and White (1995) note, their assumption that universities are profit-maximizing is potentially one reason why their theoretical predictions are not reflected in the data. More recent work does not impose profit-maximization, although there is no single objective function that has been developed to capture all of the incentives for all activities a university engages in. More recent literature on undergraduate pricing and admissions—including much of the work cited below—assumes that monetary inputs and student ability enter the objective function.



Epple et al. (2006) is the first structural empirical model of the U.S. higher education market. In Epple et al. (2006) private universities maximize quality, which is a function of the average student ability, expenditures that contribute to educational quality, and the average income of the student body.<sup>6</sup> Each of these are assumed to enter a Cobb-Douglas quality function, the parameters of which are estimated. The authors find that higher education institutions do not generally have a high degree of market power, but that the highest quality institutions do have market power that enables them to charge above a student's effective marginal cost.

Epple et al. (2017) and Epple et al. (2019) extend the work in Epple et al. (2006) by incorporating public universities, allowing heterogeneous preferences for colleges, and modeling in more detail the provision of federal student aid.<sup>7</sup> A strength of all three of these papers is the ability to explain substantial price discrimination by income. A different approach to modeling price discrimination is presented in Fillmore (2018). He models aid as the result of an auction in which very selective private universities bid for students. This model is fairly agnostic as to a university's objective; the payoff to enrolling a student is a simple function of college and student characteristics, and no economic model motivates why the university cares about these student characteristics.

A key weakness of the work on price discrimination is that these papers do not include costly applications, a friction that is consistently demonstrated to be important in empirical work on college admissions. Further, with the exception of the auction

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<sup>6</sup>The authors include the average income to justify the high degree of price discrimination by income within institutions.

<sup>7</sup>Other work has extended Epple et al. (2006) in different directions that are less relevant for the current analysis, for example Gordon and Hedlund (2019a) and Gordon and Hedlund (2019b) imbed monopolistically competitive colleges into an incomplete markets, life-cycle model to study the causes of the increase in tuition since 1987.

model in Fillmore (2018), work on price discrimination assumes a form of monopolistic competition. The current paper and Fu (2014) present equilibrium models that include costly applications and oligopolistic competition between universities, but we do not model price discrimination. An interesting direction for future research is to build a tractable model with price discrimination and costly applications.

As in Epple et al. (2006) and Fu (2014), the university objective proposed in Section 4 combines selectivity and monetary considerations. Universities value their students' academic fit at the university, which is the student test score plus an idiosyncratic measure of the student's ability to succeed at the university. Universities also value revenue net of costs ("net revenue"). The relative value of each input is estimated, so one of the outcomes of this research is to determine the extent to which universities behave as selectivity or net-revenue maximizers.<sup>8</sup> In Section 4, I provide more detail regarding the choice of objective function.

One important way in which my model differs from all previous structural models of higher education is that it implies correlation between universities' choices (prices, majors and admission thresholds) and university characteristics that are unobserved to the econometrician. This feature is typical of the extensive literature on static equilibrium models of oligopoly. The most influential paper in this literature, Berry et al. (1995) (BLP) developed an equilibrium model in which consumers make a single-discrete choice and firms set prices in Bertrand competition. They estimate the demand-side off of aggregate data using the simulated method of moments. Their paper provides an estimation strategy for handling correlation between structural

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<sup>8</sup>Because this is a static framework, I can only estimate to how universities exhibit these preferences on a year-to-year basis. It may be that by remaining selective, universities increase their long-run revenue through gifts (Hoxby, 2009). This model will not be able to determine the extent of this dynamic incentive.

firm-market unobservables and prices. While my model does not generate the same expressions for market shares, their estimation method is applicable in this context.<sup>9</sup>

The most significant new feature of the current paper is that universities choose individual strategies and are individually differentiated along a variety of endogenous and exogenous dimensions. Further, I am able to estimate this model for over 800 four-year public and private universities, instead of restricting the analysis to a more narrow slice of the market.

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<sup>9</sup>Like Fan (2013), I also extend the basic BLP framework is to allow for endogenous non-price characteristics. In her case, newspapers choose prices and characteristics, including a news quality index, the ratio of local news, and a measure of variety. In my case, universities choose prices, admission thresholds and the number and type of majors offered.

# Chapter 3

## Data

This section describes the data sources along with the empirical evidence that motivates the equilibrium model. In the first subsection, the objective is to describe the population of universities used in this study, with particular attention to the cross-sectional variation in majors offered, prices, and selectivity. In the second subsection, I define the regional structure of universities' markets. The third subsection describes the student data, both individual and aggregate.

### 3.1 University Data

The university characteristics come from the National Center for Education Statistics' (NCES) Integrated Postsecondary Education Data System (IPEDS) for the academic year 2013-14. IPEDS is a collection of university surveys on a wide range of topics such as admissions and enrollment, finances, financial aid, and degrees granted. These surveys include the entire population of postsecondary institutions in the U.S. that participate in Federal student aid programs under Title IV (such as Pell Grants and

Federal student loans).

Four-year public or private non-profit institutions located in the 48 contiguous states or the District of Columbia are the focus of this analysis. In the model and estimation, two-year colleges and for-profit institutions are included in the outside option, along with the labor market.<sup>1</sup> After imposing some restrictions on size and selectivity, the population for analysis includes 428 public universities and 466 private universities.<sup>2</sup> Enrollment at the institutions in this analysis makes up 79% of first-time enrollment of recent high school graduates at all public and private non-profit four-year institutions.

Information on offered majors is available from the IPEDS survey on degrees conferred. For each offered major and degree level, institutions report the number of degrees conferred in a given academic year.<sup>3</sup> A college major is defined using the NCES' 2010 Classification of Instructional Programs (CIP) taxonomy. This system classifies all major programs using a six-digit code, which represents a significant degree of disaggregation (see Appendix Table 1 for examples). Majors that are highly related share the first four digits of the six-digit code, and majors are further classified into broad areas using the first two digits. It is infeasible to model hundreds of these individual six-digit majors separately, so I combine CIP codes to form these

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<sup>1</sup>While there is some substitution the for-profit four-year and traditional public and private non-profit four-year sectors, the substitution is limited. For-profit institutions comprised approximately 3 percent of first-time four-year enrollment among recent high school graduates in the 2013-14 academic year. Including two-year colleges as a separate option would be an interesting way to extend this model, which I leave for future research.

<sup>2</sup>I restrict analysis to institutions that are classified in the Carnegie Classification system as Baccalaureate, Masters, or Doctoral/Research level universities. Finally, I restrict the sample to institutions of sufficient size or selectivity: institutions included have either: total undergraduate enrollment greater than 2,000, a Barron's selectivity rank of "Competitive" or higher, or receive applications from more than 2% of students in at least one state.

<sup>3</sup>Institutions report a zero when the degree is offered but no degrees are conferred, and the data are reported as missing if the degree is not available.

Table 3.1: Summary of Key University Characteristics

Variable	Public (In-State)		Private	
	Mean	St. Dev.	Mean	St. Dev.
Number of Majors	59.85	29.55	51.27	21.29
Share Arts, Social Science and Humanities	0.37	0.12	0.47	0.15
Share Business and Communications	0.13	0.06	0.14	0.08
Share Engineering, Math, and Science	0.22	0.10	0.19	0.10
List Tuition and Fees, \$1,000s	8.45	2.47	32.83	8.87
Net Tuition and Fees, \$1,000s	2.71	2.80	14.33	7.17
FTE Undergrad Enrollment (1,000s)	11.45	8.56	3.33	3.36
25th Percentile ACT	20.10	2.67	22.21	3.69
N	428		466	

NOTE: The table summarizes several key characteristics of 4-year degree-granting private non-profit or public institutions of higher education in the U.S. that are included in this analysis. See Section 3 for the inclusion criteria. The share of majors offered by type is calculated as the number of majors the university offers in each category divided by the total number of majors offered at the university. Net tuition and fees is list tuition and fees minus average grants and aid (aid that is not required to be repaid by students). In the model and estimation, tuition for public universities will be state-residence specific, although only in-state tuition is summarized here. All monetary values are in 2015 \$.

groups: 1) Arts, Social Science and Humanities, 2) Business and Communications, 3) Engineering, Math, and Science, and 4) Education, Health, Criminal Justice, and Other.<sup>4</sup> I then measure majors offered using the total count of six-digit codes, and the proportion of majors that the university offers in each group. Appendix Table 2 shows the major groups, the total number of majors that exist in the CIP system within each group, and the two-digit CIP codes that were aggregated to generate each group.

The resulting population of universities and key variables including majors offered and tuition are summarized in Table 3.1. Public universities offer nearly 60 majors on average, while private universities offer approximately 51. One key ingredient in

<sup>4</sup>The groups were chosen to combine areas of study that are loosely similar in content.

the model and estimation strategy—and indeed, one reason we might think that the number and type of majors offered might matter to students—is the heterogeneity in the number and type of majors offered. The second column in Table 3.1 shows that the standard deviation of the number of majors offered is nearly 30 majors for public universities and 21 for public universities.

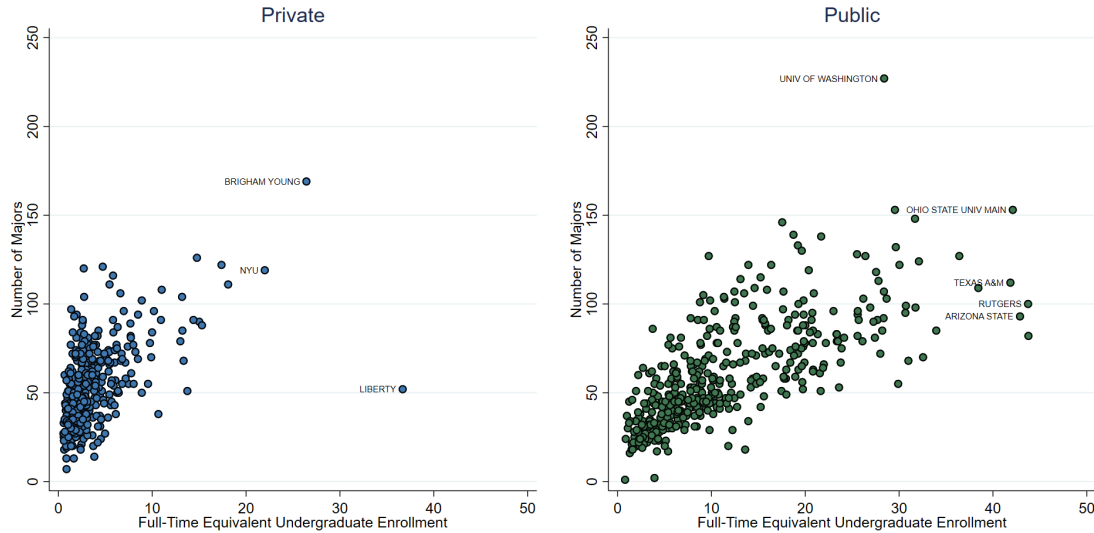
The primary source of price variation in the data is between the in-state public tuition rate and the out-of-state and private rates. Table 3.1 shows that average net tuition (tuition minus average grants and aid, excluding loans) is approximately \$2,710 per year at in-state public universities and approximately \$14,330 at private universities.

Universities are differentiated in other notable ways, including selectivity. The average of the 25th percentile ACT score within public universities is 20 (on a scale from 1 to 36), while in private universities it is 22. There is some variation within type, with a standard deviation of 2.7 for public universities and 3.7 for private universities.

Figure 3.1 shows that the number of majors offered is correlated with total enrollment. Because the number of majors offered is an equilibrium outcome, it is not clear at the outset to what extent the positive correlation with enrollment reflects demand- or supply-side factors. The model presented in this paper will generate the supply and demand functions that generate the equilibrium number of offered majors.

While Table 3.1 showed that private universities offer fewer majors on average, Figure 3.1 shows that the number of majors offered increases with enrollment more rapidly at private universities than at public universities. The fact that private universities offer more majors for a given level of enrollment suggests that public universities are able to obtain higher enrollment levels (through subsidized prices) without offering as many additional majors.

Figure 3.1: Number of Majors versus Enrollment



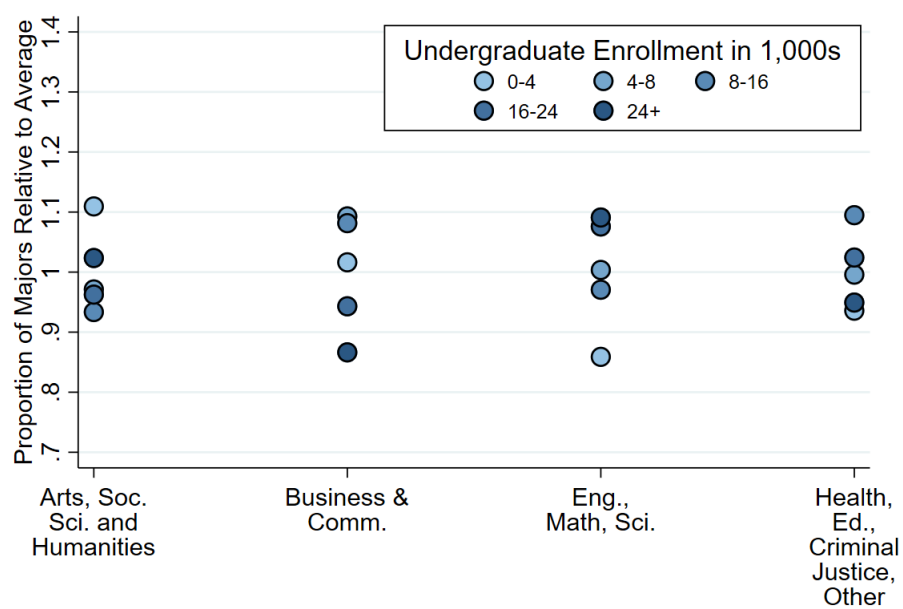
NOTE: This graph shows the total number of majors on the vertical axis and the total undergraduate enrollment on the horizontal axis. The graph was generated using the 2013-14 IPEDS data as discussed in the text.

The share of majors offered within each category is also correlated with enrollment. Figure 3.2 shows, by undergraduate enrollment, the proportion of majors that fall into each category relative to the average. Enrollment is positively correlated with the relative share of majors in Engineering, Math and Science, while smaller universities tend to have the greatest proportion of majors offered in Arts, Social Science, and the Humanities. Universities with lower enrollment tend to have a greater share in Business, although this pattern does not hold true for the smallest institutions.

In summary, the descriptive analysis evidences substantial differentiation across institutions in net tuition, the number and type of majors offered, selectivity, and other factors. The differentiation in prices, majors offered, and selectivity is likely explained by market forces, as universities choose these in response to market conditions.



Figure 3.2: Type of Majors Offered within University, by Enrollment



NOTE: This graph shows the institution's proportion of majors offered in each category relative to the average proportion in each category. This was generated using the 2013-14 IPEDS data as described in the text.

## 3.2 Regional Competition

In principle, universities may compete for students across the U.S., but enrollment data by state shows that most universities draw the majority of their enrollment from only a few states. This point has been noted as a key feature of U.S. higher education by Hoxby (1997) and Smith et al. (2018). Importantly, the set of competitors that each institution faces differs depending upon where the institution is located and how widely it draws its enrollment.<sup>5</sup>

To capture the regional structure of competition in the model, I restrict universities to compete in a set of states defined by the empirical distribution of enrollment. This implies that students' choice sets are in part determined by their geographic location. To determine which universities compete in each state, I rank the states (within university) by the proportion of the state's high school graduates that attend that university.<sup>6</sup> Then, starting from the top of the list, I select the states that together account for at least 85% of the university's total enrollment. In these computations I used ten years of data (2005-06 through 2015-16) to smooth out year-to-year fluctuations. I further restrict the set of states a university competes in by requiring that at least 0.15% of students in the state apply to that university.

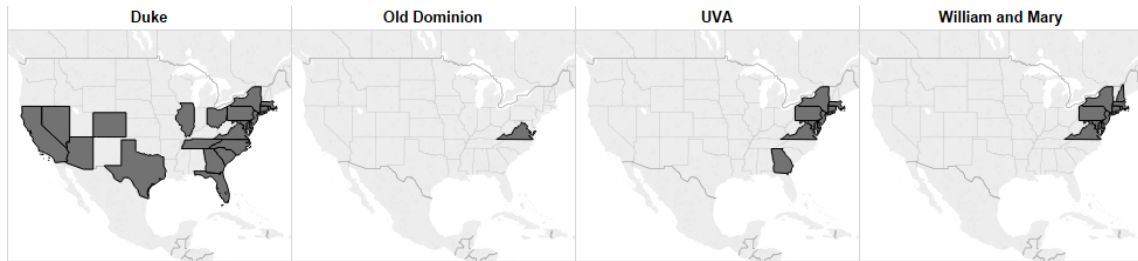
Figure 3.3 demonstrates the outcome of this method for the College of William and Mary, Duke University, Old Dominion University, and the University of Virginia. Duke is well-known nationwide and highly prestigious, so its enrollment pulls from a

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<sup>5</sup>Another implication of the localized draw of enrollment is that universities face different pools of potential students, with differing distributions of income, race, and academic ability, as noted in Hoxby and Turner (2019).

<sup>6</sup>The total number of high school graduates by state (market size) is obtained from NCES data as collected in the *Knocking at the College Door* report produced by the Western Interstate Commission for Higher Education (WICHE).

Figure 3.3: University Market Presence



NOTE: This figure shows the states in which each institution competes. To determine this set of states, states are ranked (within university) by the proportion of the state's high school graduates that attend that university. Then starting from the top of the list, states are included in the university's market until the included states make up 85% of the university's enrollment.

large number of states across the nation. The University of Virginia, while a public institution, is one of the top-ranked public institutions in the nation, so it also draws a large number of students from other states, particularly in the Northeast. The College of William and Mary, a small but highly-ranked college, draws most of its students from the Northeast as well, while Old Dominion University (a less selective public university located in Virginia) draws nearly all of its enrollment from Virginia. All four institutions are competitors in Virginia, while of these four, only Duke competes for students from Texas.

### 3.3 Student Data

Estimation of the college-choice model utilizes data on applications and enrollment by state. The IPEDS Residence and Migration Survey provides enrollment in each institution by student state of residence. I use these data to generate enrollment shares, defined as the enrollment in an institution as a proportion of the state's high school graduating class. A distribution of enrollment shares (across all states

and institutions) is summarized in the second column of Appendix Table 3. The distribution of enrollment shares is heavily right-skewed, with the enrollment share reaching 1% only at the 90th percentile, and then 16% at the maximum.

While IPEDS provides enrollment data by state, it provides no information on applications by state. Data from the SAT and the ACT admissions tests help fill this gap. When students take the SAT or ACT, they have the option to send their score reports to institutions to supplement their college applications. Because the colleges in my study require an SAT or ACT score report to accompany each application, these reports provides a proxy for applications.<sup>7</sup> The College Board and the ACT each provided a table showing the total score reports sent to each institution in the country, by student state of residence and graduation year. I link the data from the ACT and SAT by university name and then sum the total score reports across the two tests. The score-send data are summarized in the first column of Table 3. As is evident in this table, the distribution of score reports sent is also heavily right-skewed; on average, the top 10% of universities competing in each state receive 55% of all score reports sent.

The ACT and College Board also provide a distribution of test scores among test-takers in each state. Estimation of the model requires the distribution of test scores among all high school graduates. I estimate the test score distribution among all high school graduates utilizing variation in admission testing policies by state over time. The details are described in Appendix 9.1.

In addition to these sources of aggregate data, I have access to a sample of high school students from the High School Longitudinal Study 2009 (HSL:09). This

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<sup>7</sup>Card and Krueger (2005) show a high correlation between test-score sending and applications, so the SAT and ACT report-sending data may be a close approximation for applications. The universities in my study require the ACT or SAT for admission.

survey provides information on the application portfolios, admission outcomes, enrollment decisions, and student characteristics for a sample of students who were freshmen in high school in 2009. I use this sample to estimate a parameter of the admissions framework. In addition, I utilize the Education Longitudinal Study of 2002 (ELS:02) for summary statistics that inform the estimation.

In the section that follows, I describe a model in which prices, the number and type of majors offered, and selectivity are determined in equilibrium. From the model I derive estimating equations that are matched to the aggregate data on score-sends and enrollment, the individual data on admissions outcomes conditional on application, and the university-level data on prices, admission selectivity, the number and type of majors offered, and other characteristics.

# Chapter 4

## Model

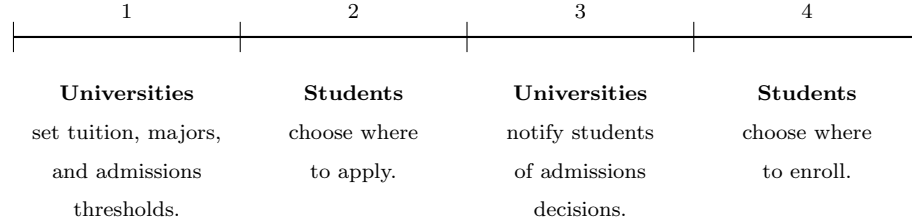
There are two types of agents in the model: high school graduating seniors (students) and universities. The timing of the model is illustrated in Figure 4.1. First, universities simultaneously choose the number of majors and the proportion in each subject category, the price (“net tuition,” which is tuition minus average grants and aid), and an admission threshold, which is a minimum measure of a student’s academic fit that the university will accept.

Students then observe the majors offered, prices, admission thresholds, and exogenous characteristics of institutions. Students do not observe their academic fit with each university, but each student knows his probability of admission given each university’s admission threshold and his college admission test score. Each student chooses an application portfolio (a set of universities to which they apply—this can include no university) based on observable university characteristics, the student’s economic cost of application, and his likelihood of admission.<sup>1</sup>

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<sup>1</sup>Note that there are several simplifications in the model thus far. First, net tuition for the upcoming year is typically announced after application deadlines. Essentially, I assume that students are able to make an accurate prediction of average net price for the upcoming year based on available

Figure 4.1: Model Timing



After applications are received, universities observe a measure of academic fit for each applicant, compare this measure to the admission threshold, and then notify each student of his admission outcome. When a student is admitted, he receives additional idiosyncratic information about his utility of attending a university. He then chooses a university to attend from the set of universities to which he was accepted, or he may choose not to attend any university.

Details on each stage follow below, in reverse chronological order. I start with the utility of enrollment, then present the admission mechanism and the value function at the application stage. Next I derive expressions for the university's share of applicants and enrollees, both of which will be used to estimate the demand parameters. I then turn to the supply side, presenting the university's objective function and first-order conditions for majors, net tuition, and admission thresholds.

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information, such as last year's net price. Second, the admission criteria that an individual university uses are unobserved, and are potentially quite complex. However, test scores are likely the primary predictor of admission at the universities in this study, and good information is widely available on the average and percentiles of admission test scores within institution. I assume that students predict their admission probabilities based on this information and their own test scores.

## 4.1 Student Utility from Enrollment

At the application stage, each student chooses an application portfolio that maximizes his expected utility of enrollment net of application costs. Thus, the first step toward a fully specified model of college choice is to define the utility of enrolling in a university.

Let  $l = 1 \dots L$  denote the high school graduate's state of residence. There are  $J + 1$  universities  $j = 0, 1, \dots, J$ , where  $j = 0$  represents the outside option of four-year colleges not included here (such as for-profit universities), two-year colleges, other educational certificate programs, the labor market, or other options. Each university offers a number of majors within each of  $K$  broad categories. Let  $\mathbf{M}_j$  be a  $K \times 1$  vector where the first element,  $M_{j1}$  is the total number of majors university  $j$  offers, and the remaining  $K - 1$  elements are the proportion of majors of each type relative to an excluded category. Universities also have a number of exogenous characteristics,  $\mathbf{X}_{jl}$ , such as whether the university is under private or public control and the distance to the population center of each state. Universities charge a net tuition,  $p_{jl}$ , which is tuition minus average grants and aid. For private universities, this price will be constant across  $l$ , while for public universities, the price varies by in-state status (whether  $l$  is the state where  $j$  is located).

The utility individual  $i$  receives from enrolling at university  $j$  is:

$$u_{ijl} = \beta_0 + \beta_1 p_{jl} + \beta_2 \mathbf{M}_j + \beta_3 \mathbf{X}_{jl} + \xi_{jl} + \eta_{ijl} \quad (4.1)$$

The student-specific error,  $\eta_{ijl}$ , is distributed Type I Extreme Value. This error represents information that becomes known to the student after his acceptance and that may have different value to different students (e.g., information about campus



dining options presented during a campus tour). The university-specific error  $\xi_{jl}$  represents the mean value of university characteristics unobserved to the researcher but known to students before application, such as a reputation for the quality of amenities like the gym, libraries, and dorms.

Let  $\mathbf{D}$  be a  $(J + 1) \times 1$  vector, where  $D_j = 1$  represents an admission offer at university  $j$  and  $D_j = 0$  represents no admission offer, whether this is because the student did not apply or because the university rejected the student. Students may always choose not to attend any college ( $D_0 = 1$ ), in which case they receive a mean utility which is normalized to zero.

Let  $\nu_j = u_{ij} - \eta_{ij}$ , with the state subscripts dropped for notational simplicity. Because of the Type I Extreme Value assumption on  $\eta_{ij}$ , the probability that a student enrolls in a particular university among universities that admitted the student is given by the usual conditional logit expression. If the university does not admit the student, then the probability of enrollment is zero.

$$\mathbb{P}(Enroll_{ij}|\mathbf{D}) = \begin{cases} \frac{e^{\nu_{ij}}}{\sum_{j' \ni D_{j'}=1} e^{\nu_{j'}}}, & \text{if } \mathbf{D}_j = 1 \\ 0, & \text{if } \mathbf{D}_j = 0. \end{cases} \quad (4.2)$$

## 4.2 Admission Probabilities

At the admission stage (Stage 3 in Figure 4.1), universities observe each student's academic fit and compare this value to the pre-determined admission threshold. Universities then inform each student about his admission outcome. In this section I describe the structure of the admission process, which will give rise to a probability of admission for each student. This probability will enter the application value

function in Stage 2.

Each student has a test score,  $s_i$ , which is known to the student and is observed by the university at the admission stage. Prior to the admission stage, the university knows the distribution of test scores among all high school graduates. At the admission stage, the university also sees an idiosyncratic measure of a student's academic fit,  $\zeta_{ij}$ , which is distributed  $N(0, \sigma^2)$ . This value captures idiosyncratic components of a student's fit at the university, which an admissions officer may infer from recommendations, essays or interviews. Students know only its distribution. Universities see only this idiosyncratic measure for their own applicants. Furthermore, universities do not know how many or which universities have received applications from each student.

The admission decision is based upon an admission index, which is the sum of the academic fit and the observed test score:  $s_{ij} = s_i + \zeta_{ij}$ . Universities compare this value to the admission rule, which is a threshold,  $\underline{s}_j$ .<sup>2</sup> Given the admission threshold, the student's score, and the distribution of the academic fit, each student compute his probability of admission to each university. This is:

$$\mathcal{P}(D_j = 1 | s_i, \underline{s}_j) = \text{Prob}(s_i + \zeta_{ij} > \underline{s}_j) = \Phi((s_i - \underline{s}_j)/\sigma), \quad (4.3)$$

where  $\Phi(\cdot)$  is the standard normal CDF. This will be the first estimating equation, from which I will estimate  $\sigma$ .

Let  $\mathbf{Y}$  be a vector indicating the student's application portfolio.  $\mathbf{Y}$  is a  $(J+1) \times 1$  vector where the element  $Y_j = 1$  if the student applies to school  $j$  and 0 otherwise.

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<sup>2</sup>While one can conceive of admission rules that are not thresholds (such as a lottery among applicants), I assume that universities must set thresholds. The higher education industry is always under intense public scrutiny, and the threshold rule is consistent with public perception that university admission in the U.S. should be a meritocratic process.

The student always “applies” to the outside option  $j = 0$ . Given the admission probabilities and the assumption of independent admission outcomes conditional on test scores, students have the following probability of being admitted to a set  $\mathbf{D}$  conditional on their academic skill and application portfolio:

$$\mathcal{P}(\mathbf{D}|s_i, \mathbf{Y}) = \prod_{j \ni Y_j=1, D_j=1} \mathcal{P}(D_j = 1|s_i, \underline{s}_j) \prod_{j \ni Y_j=1, D_j=0} [1 - \mathcal{P}(D_j = 1|s_i, \underline{s}_j)]. \quad (4.4)$$

### 4.3 Application Value Function

Each student chooses an application portfolio to maximize his expected utility of enrollment net of application costs. To derive this expected value, we can first find the utility  $i$  receives from being accepted to  $\mathbf{D}$ . This is the expected value of the maximum utility among the universities represented by  $\mathbf{D}$ , which can be expressed using the log-sum formula, as I have assumed the  $\eta_{ij}$  are Type-I Extreme Value (with location and scale parameters normalized to 0 and 1, respectively):

$$v(\mathbf{D}) = \ln\left(\sum_{j \text{ s.t. } D_j=1} e^{\nu_{ij}}\right) + \gamma, \quad (4.5)$$

where  $\gamma$  is the Euler–Mascheroni constant. This constant cancels out of the choice probabilities as it does not change the relative utility of any option, and will be dropped in the remaining exposition.

The value of an application portfolio is the expected utility of enrollment given the probability of acceptance at each university, net of cost of application. As discussed in the previous section, the probability of being admitted to  $\mathbf{D}$ , conditional on the

student's skill level,  $s_i$ , and application portfolio,  $\mathbf{Y}$ , is denoted by  $\mathcal{P}(\mathbf{D}|s_i, \mathbf{Y})$ .

Then the expected value of an application portfolio  $Y$  for individual  $i$  is:

$$V(\mathbf{Y}|s_i) = \sum_{\mathbf{D} \subseteq \mathbf{Y}} (\mathcal{P}(\mathbf{D}|s_i, \mathbf{Y})v(\mathbf{D})) - c(\mathbf{Y}) + \epsilon_{i\mathbf{Y}}, \quad (4.6)$$

where  $c(\mathbf{Y}) - \epsilon_{i\mathbf{Y}}$  represents  $i$ 's cost of application to  $\mathbf{Y}$ .  $\epsilon_{i\mathbf{Y}}$  is a Type I Extreme Value error that captures unobserved elements of the cost of application. This unobserved component could include application completion time associated with different application procedures across schools (everything from different log-in requirements for the online application system to different application essay topics or lengths).<sup>3</sup>

Based on the individual utility of enrollment and value for each application portfolio, the next step is to generate expressions for market-level statistics that can be used to estimate the parameters with aggregate data. In the next section I derive the two estimating equations for the demand-side parameters.

## 4.4 Aggregate Applications and Enrollment

In this section, I derive two expressions that are matched to the data by market. The first is the market penetration of each university, defined as the proportion of high school graduates in each state who apply to the university. The second expression is the analogous enrollment share by market.

Each student faces a unique set of application portfolios from which to choose (choice set), which I denote  $\Upsilon_i$ . The empirical specification of these choice sets is in

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<sup>3</sup>I assume this cost error is uncorrelated with the individual preferences for specific universities. I also assume it is independent across application sets. The latter is a weakness that will be addressed in future work through a Generalized Extreme Value assumption on the error term, as in (Bresnahan et al., 1997) and (Arcidiacono, 2005).

part determined by the student's geographic location, and is in part random. The limitations on choice sets are discussed in further detail in Section 6.1.

Conditional on the choice set  $\Upsilon_i$  and the student's test score  $s_i$ , the probability that an individual applies to an application portfolio  $\mathbf{Y}$  is:

$$\mathbb{P}(\text{Apply}_{\mathbf{Y}}|s_i, \Upsilon_i) = \frac{e^{\tilde{V}(\mathbf{Y}|s_i)}}{\sum_{\mathbf{Y}' \in \Upsilon_i} e^{\tilde{V}(\mathbf{Y}'|s_i)}}, \quad (4.7)$$

where  $\tilde{V}(\mathbf{Y}|s_i) = V_i(\mathbf{Y}|s_i) - \epsilon_{i\mathbf{Y}}$ . Summing this expression across all application portfolios that include  $j$  gives the total probability that  $i$  applies to university  $j$ :

$$\mathbb{P}(\text{Apply}_j|s_i, \Upsilon_i) = \frac{\sum_{\mathbf{Y} \ni Y_j=1} e^{\tilde{V}(\mathbf{Y}|s_i)}}{\sum_{\mathbf{Y} \in \Upsilon_i} e^{\tilde{V}(\mathbf{Y}|s_i)}}. \quad (4.8)$$

Aggregating to the market-level provides the market penetration function for  $j$ :

$$a_j = \mathbb{P}(\text{Apply}_j) = \sum_s \sum_{\Upsilon} \sum_{\mathbf{Y} \in \Upsilon \ni Y_j=1} \mathbb{P}(\text{Apply}_{\mathbf{Y}}|s, \Upsilon) P(\Upsilon) P(s) \quad (4.9)$$

Equation 4.9 becomes the second estimating equation. The model market penetration,  $a_j$ , will be matched to the observed proportion of students who apply to each university,  $A_j$ , at the market level.

Here we can observe a key distinction between this multiple discrete choice framework and the models of demand typical of the single discrete choice literature following Berry et al. (1995). The sum of the market penetration of applications,  $\sum_j a_j$ , yields a number greater than one, because each application portfolio will be counted as many times as universities it contains. In other words, if a student applies to three universities, that student is counted in the market penetration of applications for each

of the three universities.

The second equation used in estimation is the first-year enrollment share within each market. For an individual, the probability of enrolling in university  $j$ , unconditional on admission decisions, is:

$$\mathbb{P}(Enroll_j|s_i, \Upsilon_i) = \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \mathbb{P}(Apply_{\mathbf{Y}}|s_i, \Upsilon_i) \sum_{\mathbf{D} \in \mathbf{Y}} \mathcal{P}(\mathbf{D}|s_i, \mathbf{Y}) \mathbb{P}(Enroll_j|\mathbf{D}). \quad (4.10)$$

Each component of this expression has been described before. They are, respectively, the probability of application to a specific application portfolio conditional on the student's test score and choice set (equation 4.7), the probability of acceptance to a set of universities conditional on the student's applications and test score, (equation 4.4), and the probability of enrollment conditional on the student's admissions outcomes (equation 4.2).

Aggregating to the market-level yields the following expression for the enrollment share,  $e_j$ , which is the third estimating equation:

$$e_j = \mathbb{P}(Enroll_j) = \sum_s \sum_{\Upsilon} \mathbb{P}(Enroll_j|s, \Upsilon) P(\Upsilon) P(s). \quad (4.11)$$

In this section so far, I have described the college choice model and admissions mechanism and derived the estimating equations for the college choice and admissions parameters. To recap, the estimating equations are: 1) The probit expression for each student's admission probability in Equation 4.3, 2) the market penetration function (or applicant share) in Equation 4.9, and 3) the market-level enrollment share in Equation 4.11. In the next two subsections, I turn to the supply-side. I first present the university objective function and then the first-order conditions for the setting of

majors offered, net tuition, and admission thresholds.

## 4.5 The University Objective Function

A university is a complex institution, with potentially many factors in an objective function that is not well-understood. The universities in this study are not for-profit institutions, so the standard models of firm behavior may be of limited applicability. This research moves toward a better understanding of university behavior, although I do not claim to have modeled every aspect of a university's operations.

In this model, universities choose majors, net tuition, and admission thresholds to maximize their objective subject to student and competitor behavior. Both public and private universities potentially value selectivity and revenue net of cost of providing undergraduate education (“net revenue”). Selectivity is measured as the average student's rank among all high school graduates. The inclusion of the selectivity term is required to reflect the fact that universities reject students — if universities only valued profit, prices would adjust upwards and no student would be rejected. Net revenue is included in the objective because universities may value having financial resources which can be used to support research, graduate education, or other programs.

Universities make their decisions before the heterogeneous components of application costs, academic fit, and enrollment utility are realized, thus the enrollment and the average student's preparation are in expectation. They rank the expected average student preparation, compute profit based on the expected enrollment, and then weight the two inputs.

There are three distinctions between public and private universities in this model.

First, public universities may put different weight on selectivity relative to profit. Second, public universities may have different costs, and third, they have the option of charging different in-state and out-of-state prices. Public universities typically have much lower in-state prices than out-of-state prices as a result of their interaction with state legislatures, which provide appropriations to support the low in-state rates. While I do not model the state legislature explicitly, public universities will internalize legislative preferences through a term capturing an additional value for enrolling an in-state student.

#### 4.5.1 Private University Objective

Private universities choose prices, majors, and an admission threshold to maximize a Cobb-Douglass in selectivity and net revenue:

$$\max_{p_j, \mathbf{M}_j, \mathbf{S}_j} \tilde{s}(\mathbf{s}_j)^{\lambda_j} (\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j))^{1-\lambda_j}, \quad (4.12)$$

where  $\tilde{s}(\mathbf{s}_j)$  is the ranking (by admission index) of the average student.  $\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)$  is expected revenue minus economic cost. The university-specific  $\lambda_j$  takes the form:  $\lambda_j = \lambda_0^{priv} + \epsilon_j^s$  if  $j$  is a private university, so  $\lambda_0^{priv}$  is a parameter governing the average private university's preference for selectivity.

In the following paragraphs I define the elements of the university objective more precisely. As a preliminary, I define the enrollment of the university. Section 4.4 provides an equation for the enrollment share in each market ( $\mathbb{P}(Enroll_{jl})$ ) as a function of the university's choice of prices, admission thresholds and offered majors. Multiplying by  $N_l$  (the market size) gives the enrollment for each institution from each



market:

$$q_{jl} = N_l \mathbb{P}(Enroll_{jl}).$$

Summing  $q_{jl}$  over all markets gives the total first-year enrollment,  $q_j$ :

$$q_j = \sum_l N_l \mathbb{P}(Enroll_{jl}).$$

Revenue per student includes the net tuition  $p_j$ , financial aid paid by sources outside the university, and non-tuition revenues such as private gifts. Per-student financial aid from outside sources will be denoted with  $t_j$ . Other revenue sources such as private gifts,  $\psi_j$ , will be assumed to scale with enrollment. Then the private institution's revenue can be written as:

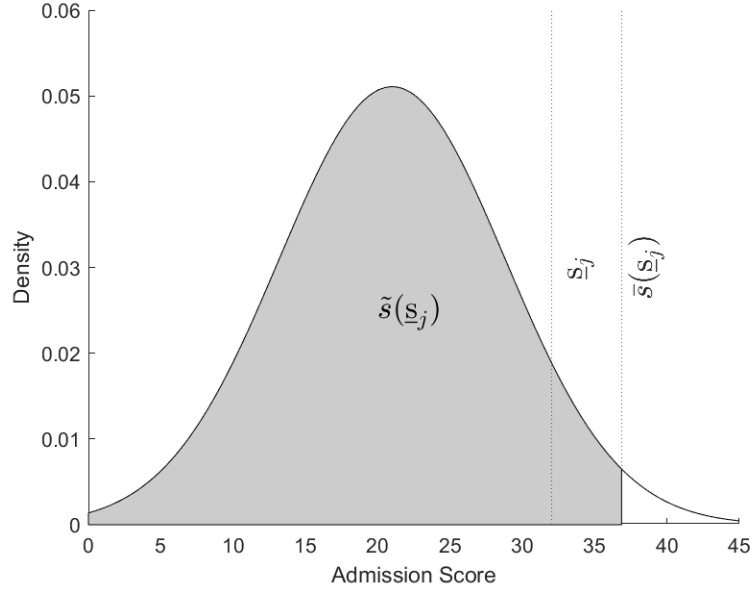
$$\mathcal{R}_j(p_j) = (p_j + t_j + \psi_j)q_j$$

Cost is a function of majors offered, enrollment, and certain exogenous characteristics of the universities ( $\mathbf{X}^c$ ), with a flexible form that allows for non-linearity in both majors and enrollment:

$$\mathcal{C}(\mathbf{M}_j) = q_j(\alpha_0^{priv} + \alpha_1^{priv} \mathbf{M}_j + \alpha_2^{priv} q_j + \alpha_3^{priv} q_j \mathbf{M}_j + \alpha_4^{priv} \mathbf{M}_j^2 + \alpha_5^{priv} \mathbf{X}_j^c + \omega_j).$$

I let  $\omega_j = \omega_{0j} + \sum_{k=1}^K M_{jk} \omega_{kj}$ . Thus marginal cost is heterogeneous, and may depend on the offered majors. This term may reflect cost differences due to differences in quality across universities.

The ranking of the average student by admission index,  $\tilde{s}_j(\underline{s}_j)$ , is constructed in two steps as illustrated in Figure 4.2. First, I find the model prediction for the average

Figure 4.2: Calculating  $\tilde{s}(\underline{s}_j)$ 

NOTE: This figure illustrates the calculation of the percentile rank of the average student, as described in the text.

of the admission scores ( $s_{ij} = s_i + \eta_{ij}$ ) among enrollees. This average depends on the admission threshold  $\underline{s}_j$ , but also on the demand system that generates the distribution of scores among enrollees. This is the  $\bar{s}_j$  in the figure.

Then this average score is ranked against the distribution of all students' admission scores. The distribution of the admission scores is normal, so the CDF of the admission test score yields the percentile rank of the average student.

#### 4.5.2 Public University Objective

The objective for public universities is very similar to that of private universities in form, except that public universities separately choose in-state and out-of-state

prices. The parameters of the model are also allowed to differ, so public universities may have different costs and preference for selectivity. The public university objective is:

$$\max_{p_j^{is}, p_j^{os}, \mathbf{M}_j, \underline{s}_j} \tilde{s}(\underline{s}_j)^{\lambda_j} (\mathcal{R}(p_j^{is}, p_j^{os}) - C(\mathbf{M}_j))^{1-\lambda_j}. \quad (4.13)$$

The average public university preference for selectivity is allowed to differ from that of private universities, so  $\lambda_j = \lambda_0^{pub} + \epsilon_j^s$  for a public university.

For public universities, revenue depends upon both the in-state and out-of-state prices,  $p_j^{is}$  and  $p_j^{os}$  and in-state and out-of-state enrollments,  $q_j^{is}$  and  $q_j^{os}$ . Financial aid is assumed to be the same for in-state and out-of-state students, as data limitations prevent making a distinction. Appropriations are assumed to be a per-student rate for in-state students only, which creates a distinction between  $\psi_j^{is}$  and  $\psi_j^{os}$ .

$$R_j(p_j^{is}, p_j^{os}) = (p_j^{is} + t_j + \psi_j^{is})q_j^{is} + (p_j^{os} + t_j + \psi_j^{os})q_j^{os}.$$

The economic cost associated with each student is allowed to vary between in-state and out-of-state students for public universities, as they may have a mandate to serve in-state students. The cost function for public universities is as follows:

$$C(\mathbf{M}_j) = q_j(\alpha_0^{pub} + \alpha_1^{pub}\mathbf{M}_j + \alpha_2^{pub}q_j + \alpha_3^{pub}\mathbf{M}_jq_j + \alpha_4^{pub}\mathbf{M}_j^2 + \alpha_5^{pub}\mathbf{X}^c + \omega_j) + q_j^{is}(\alpha_6^{pub} + \omega_{0j}^{is}),$$

so that  $\alpha_6^{pub} + \omega_{0j}^{is}$  reflects the extent to which public universities value in-state enrollment relative to out-of-state enrollment.

Given these objectives, public and private universities will simultaneously set majors offered, prices, and admission thresholds. The next section derives the first-order

conditions to provide some economic intuition and to prepare for the identification and estimation of the model.

## 4.6 University First-Order Conditions

Universities set majors, prices, and admission thresholds simultaneously in order to maximize their objectives. Thus, observed choices are assumed to be solutions to the first-order conditions derived from the model. In this section I derive the first-order conditions, first for private and then public universities.

### 4.6.1 Private University First-Order Conditions

The pricing condition for a private university is:

$$\underbrace{\frac{\lambda_j}{(1 - \lambda_j)} \frac{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)}{\tilde{s}(\underline{s}_j)}}_{MRS} = - \underbrace{\frac{\frac{\partial \mathcal{R}(p_j)}{\partial p_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial p_j}}{\frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j}}}_{\text{Slope of Net Revenue/Selectivity Frontier}}.$$

The left hand side is the marginal rate of substitution between selectivity and net revenue. In a standard model of consumer behavior or of production, the marginal rate of substitution between two goods would be balanced with a price ratio derived from a budget constraint. Here, the “budget constraint” is a relationship between selectivity and net revenue, which I will refer to as the “Net Revenue-Selectivity Frontier.” This is an implicit relationship between selectivity and net revenue that derives from the demand-side framework. As prices change, selectivity is affected through demand, with differential effects across the student test score distribution. Prices also affect net revenue directly and indirectly through changes in enrollment.

This relationship traces out a feasible combination of selectivity and net revenue, which differs by university depending upon the university's characteristics and market conditions. The net revenue derivative with respect to price is:

$$\frac{\partial \mathcal{R}(p_j)}{\partial p_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial p_j} = (p_j + t_j + \psi_j) \frac{\partial q_j}{\partial p_j} + q_j - \frac{\partial q_j}{\partial p_j} (c_j(\mathbf{M}_j) + q_j(\alpha_2^{priv} + \alpha_3^{priv} \mathbf{M}_j)),$$

where I let  $c_j(\mathbf{M}_j) = \alpha_0^{priv} + \alpha_1^{priv} \mathbf{M}_j + \alpha_2^{priv} q_j + \alpha_3^{priv} \mathbf{M}_j q_j + \alpha_4^{priv} \mathbf{M}_j^2 + \omega_j^s$  represent the cost per student. The derivatives  $\frac{\partial q_j}{\partial p_j}$  and  $\frac{\partial \tilde{s}_j(\underline{S}_j)}{\partial p_j}$  are computed numerically.

In addition to price, universities also choose an admission threshold and the  $K$  variables that measure the number and type of majors offered. All of the derivatives have a similar form from the Cobb-Douglas objective function. The admission threshold first-order condition for a private university is:

$$\underbrace{\frac{\lambda_j}{(1 - \lambda_j)} \frac{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)}{\tilde{s}(\underline{S}_j)}}_{MRS} = - \underbrace{\frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{S}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{S}_j}}{\frac{\partial \tilde{s}(\underline{S}_j)}{\partial \underline{S}_j}}}_{\text{Slope of Net Revenue/Selectivity Frontier}}.$$

When setting the admission threshold the university trades off the effect of the admission threshold on net revenue with the effect on selectivity. Selectivity is increasing in the admission threshold, while net revenue is decreasing in the admission threshold at the solution.

Figure 4.3 provides an illustration for intuition. The figure is generated using an example university and the estimated coefficients, but is meant only to be illustrative of the mechanics of the model. The solid green lines show the university's indifference curves between selectivity and net revenue. A university's objective is increasing as indifference curves shift towards the top-right. The optimal admission threshold is

at the point of tangency between these indifference curves and the selectivity/net-revenue frontier, which gives the implied selectivity and net-revenue generated from the demand-side framework at each level of the admission threshold. In this graph, prices and majors are held constant.

At an infinitely high admission threshold, the university admits no students and net revenue is zero. This is the bottom-right corner of the graph. As the admission threshold decreases, net revenue increases because the university admits more students, but selectivity decreases. At some point, the marginal cost per student increases to the point where an additional student actually reduces the net revenue. The university's relative preference for selectivity will determine how close or far the optimal admission threshold is from the net-revenue maximizing point. Provided the preference for selectivity is positive, the optimal admission threshold is higher than the net-revenue maximizing point.

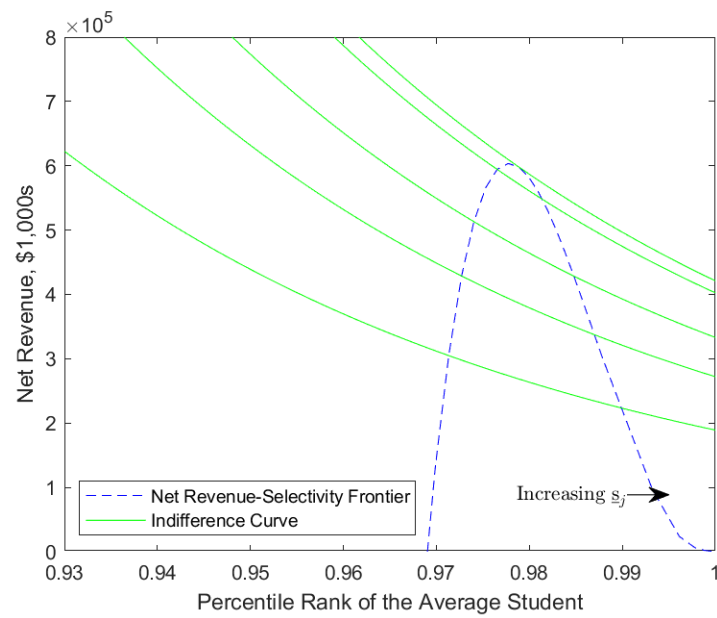
The derivative of revenue with respect to the admission threshold is negative, because increasing the admission threshold can only decrease the enrollment:

$$\frac{\partial \mathcal{R}_j(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{s}_j} = (p_j + t_j + \psi_j) \frac{\partial q_j}{\partial \underline{s}_j}.$$

The derivative of cost with respect to the admission threshold is similar to the derivative with respect to price, because the admission threshold and the price both affect cost only through the level of enrollment:

$$\frac{\partial \mathcal{C}_j(\mathbf{M}_j)}{\partial \underline{s}_j} = \frac{\partial q_j}{\partial \underline{s}_j} (c_j(\mathbf{M}_j) + q_j(\alpha_2^{priv} + \alpha_3^{priv} \mathbf{M}_j)).$$

Figure 4.3: Optimization: Admission Threshold



NOTE: This figure illustrates the optimization over the admission threshold for an example university. The solid lines show the indifference curves between selectivity and net revenue. The dashed line shows the possible combinations of selectivity and net revenue as the admission threshold increases, keeping prices and majors offered fixed. The optimum is found at the point of tangency.

Finally, I find the first-order condition for a given  $k$ :

$$\underbrace{\frac{\lambda_j}{(1 - \lambda_j)} \frac{\mathcal{R}(p_j) - C(\mathbf{M}_j)}{\tilde{s}(\underline{\mathbf{S}}_j)}}_{MRS} = - \underbrace{\frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial M_{jk}} - \frac{\partial C(\mathbf{M}_j)}{\partial M_{jk}}}{\frac{\partial \tilde{s}(\underline{\mathbf{S}}_j)}{\partial M_{jk}}}}_{\text{Slope of Net Revenue/Selectivity Frontier}}.$$

As with the other conditions, the university trades sets the slope of the net revenue/selectivity frontier with respect to  $M_{jk}$  equal to the marginal rate of substitution between selectivity and net revenue. The derivatives of revenue with respect to the measures of the number and type of majors offered are:

$$\frac{\partial R_j(p_j)}{\partial \underline{\mathbf{S}}_j} = (p_j + t_j + \psi_j) \frac{\partial q_j}{\partial M_{jk}},$$

so majors affect revenue only through enrollment. The derivatives of cost with respect to the  $M_{jk}$  include the cost of offering the majors and the effect on enrollment:

$$\frac{\partial C_j(\mathbf{M}_j)}{\partial M_{jk}} = \frac{\partial q_j}{\partial M_{jk}} c_j(\mathbf{M}_j) + q_j (\alpha_{1k}^{priv} + \alpha_{2k} \frac{\partial q_j}{\partial M_{jk}} + \alpha_{3k}^{priv} q_j + \frac{\partial q_j}{\partial M_{jk}} \alpha_3 \mathbf{M}_j + 2\alpha_{4k}^{priv} M_{jk} + \omega_{jk}).$$

Some algebra produces meaningful expressions for the markup (price minus marginal cost), the  $\lambda_j$ , and the supply of majors. First, for private universities, I solve the price and admission threshold first-order conditions to obtain an expression for marginal cost:

$$c_j(\mathbf{M}_j) + q_j (\alpha_2^{priv} + \alpha_3^{priv} \mathbf{M}_j) = p_j + t_j + \psi_j + q_j \frac{\frac{\partial \tilde{s}(\underline{\mathbf{S}}_j)}{\partial \underline{\mathbf{S}}_j}}{\left( \frac{\partial \tilde{s}(\underline{\mathbf{S}}_j)}{\partial \underline{\mathbf{S}}_j} \frac{\partial q_j}{\partial p_j} - \frac{\partial \tilde{s}(\underline{\mathbf{S}}_j)}{\partial p_j} \frac{\partial q_j}{\partial \underline{\mathbf{S}}_j} \right)}.$$



This expression shows that the markup (difference between marginal cost and price) is a function of both the price effect on selectivity and the price effect on the enrollment level. If the effect of price on selectivity is zero  $\left(\frac{\partial \bar{s}(\underline{\mathbf{S}}_j)}{\partial p_j} = 0\right)$ , then the markup is equivalent to that of a profit-maximizing firm in a standard model of oligopoly.

Next I take the ratio of the major supply first-order conditions to the pricing first-order conditions and obtain this expression for each  $k$ :

$$M_{jk} = \frac{\left(-\frac{\beta_{2k}}{\beta_1} - \alpha_1^{priv}\right)}{\alpha_{4k}^{priv}} - \frac{\alpha_{3k}^{priv}}{\alpha_{4k}^{priv}} q_j - \frac{\omega_{jk}}{\alpha_{4k}^{priv}}. \quad (4.14)$$

So the level of each element of  $\mathbf{M}_j$  is a linear function of enrollment and the universities' heterogeneous cost for each major.

Finally, an expression for  $\lambda_j$  can be obtained from the first-order condition for the admission threshold:

$$\frac{\frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{\mathbf{S}}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{\mathbf{S}}_j}}{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)}}{\left(\frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{\mathbf{S}}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial \underline{\mathbf{S}}_j}}{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)}} - \frac{\frac{\partial \bar{s}(\underline{\mathbf{S}}_j)}{\partial \underline{\mathbf{S}}_j}}{\bar{s}(\underline{\mathbf{S}}_j)}\right)} = \lambda_j. \quad (4.15)$$

#### 4.6.2 Public University First-Order Conditions

Similarly to the private universities, a public university has first-order conditions for prices, admission thresholds, and each measure of the number and type of majors offered. One distinction between public and private universities is that the public universities have two pricing first-order conditions, one for the in-state price and

one for the out-of-state price. For each price, the university trades off the effect on selectivity with the effect on net revenue.

Just as for private universities, the public universities' first-order conditions can be solved to produce a series of equations that are linear in the error terms. They are significantly more complicated because of the distinction between in-state and out-of-state rates, and are not significantly more instructive. I include these equations in Appendix 9.4.

In this section, I presented a the model of the supply-side of higher education that features a trade-off between net revenue and selectivity. Universities choose prices, an admission threshold, and the number and type of majors offered. Universities have heterogeneous preferences for selectivity and heterogeneous costs, and public and private universities may differ in average preference for selectivity and average costs. Public universities are allowed to choose different in-state and out-of-state prices, and they internalize the government's preference for in-state students. In the next section, I describe how the parameters of the admission mechanism, enrollment utility and application cost, and the university objective are identified.

# Chapter 5

## Identification

The parameters of the model include the variance of the student-university match value in the model of admissions, the enrollment utility parameters and the application cost parameters in the college choice problem, and the cost and preference parameters for universities. In the following subsections, I explain how each parameter is identified. The order of the presentation foreshadows the estimation strategy.

### 5.1 Identification: Admissions

The variance of the student-university match value,  $\sigma$ , governs how informative test scores are in the admission process. Recall from the model that the likelihood of admission to a university conditional on the student's test score  $s_i$  and the university's admission threshold  $\underline{s}_j$  is  $\Phi((s_i - \underline{s}_j)/\sigma)$ , where  $\Phi(\cdot)$  is the standard normal CDF. As the variance  $\sigma$  becomes large, students' test scores become less and less informative about their admission probability. With individual application and admission data, the level of  $\sigma$  is identified by the variance of admission outcomes among students with

the same difference between their test score and the university's threshold.

## 5.2 Identification: Enrollment Utility and Application Cost

The next set of parameters to identify are the parameters governing the enrollment utility and application cost, which can be found in equations 4.1 and 4.6. One identification concern is that observed university characteristics may be correlated with the unobserved university characteristics that enter the utility of enrollment. This will be the case for price and majors offered, as universities decide the prices and majors with knowledge of these unobserved characteristics. This is an endogeneity problem that is standard in the Industrial Organization literature (see Berry et al. (1995); Nevo (2000); Fan (2013)). Setting aside this concern for the moment, there remains the question of how each parameter can be separately identified using data on applications and enrollment. I discuss this issue first and then discuss my solution to the endogeneity problem.

The parameters that govern the mean utility of enrollment ( $\beta_0, \beta_1, \beta_2, \beta_3$ ) are separately identified by the covariation of the application and enrollment outcomes (application market penetration and enrollment share) and the university characteristics. All else equal, universities with a higher mean utility will receive applications from and ultimately enroll a greater proportion of high school graduates. Note that all of these parameters are interacted both with the corresponding university characteristic and the probability of admission, since they are within the expected value of an application portfolio. This means that, for example, while  $\beta_0$  does govern the

average utility of college enrollment, it also reflects the extent to which students value the probability of admission. As  $\beta_0$  increases, students will be more likely to apply to every college, but the effect of  $\beta_0$  varies with the admission probability: high  $\beta_0$  implies that students will apply more often to “safe” options.

Applicant cost parameters capture the economic cost of each application. The constant in the application cost reflects the average level of applications overall, relative to the number of potential applicants who choose not to apply to any university. If this parameter is high, most students will send no college application, and if it is low, then students will be more likely to send at least one, which will generate a higher level of applications overall. The parameter on the log number of applications in the portfolio reflects the skewness of the distribution of applications within a market, apart from how the skewness is driven by similarities in characteristics of universities in the same market. If this parameter is very large, then the second, third, and fourth applications are very costly relative to the first application, and most students will then send only one application. Because students will send only one application, they will be forced to choose between universities (based on their characteristics) and therefore the number of applications sent to the top university in the market will be very different from the number of applications sent to the second, and so on. On the other extreme, if the second, third and fourth applications were perfectly costless for all students, then all students who apply will send four applications, which increases the complementarity in applications and reduces the difference in application shares between institutions with different mean utilities.

Now we can return to the issue of the endogeneity of prices and majors. Without instruments, the estimated coefficients on price and majors offered in utility will be biased, because prices and majors are correlated with university characteristics that

I do not observe  $(\xi_j)$ . Thus, I need appropriate instruments for price and majors offered. In addition, I need instruments to identify the parameters on the number of applications within a portfolio, as the number of applications a student sends is a function of majors and prices at each institution. The following paragraphs describe the instruments and arguments for exogeneity and relevance.

For prices, the primary source of identification is an in-state indicator for public institutions. This is a valid instrument under the assumption that the only reason a student would choose to attend an in-state institution instead of an out-of-state institution with the same observed characteristics is the price difference.

Instruments for majors offered are the number and type of graduate programs the university offers, measured the same way as for the undergraduate programs. These are relevant instruments (see Appendix 9.2), and I argue that the relevance comes through correlation in the unobserved cost of providing each major. Exogeneity follows from the assumption that the decision to offer graduate programs is independent of demand for undergraduate education.

I use a state's average distance from the universities competing in the state as an instrument for the number of applications sent. Distance to each state is presumably exogenous to current demand shocks because universities largely chose their location many years prior to 2013, and location is relatively fixed. The instrument is correlated because students will generally apply to universities that are close, so students who live in remote states are unlikely to send as many applications as students who live in states that are home to many universities.

### 5.3 Identification of Supply Parameters

The supply-side parameters to be identified are the average public and private university preference for selectivity ( $\lambda_0^{priv}$  and  $\lambda_0^{pub}$ ), and the marginal cost parameters  $\alpha$  for both public and private universities. In this section I discuss the conditions under which the parameters are identified.

First, I focus on the first-order conditions for the private universities. The estimating equations derived from the the majors first-order conditions are given by equation 4.14. These  $K$  equations can be re-written as:

$$M_{jk} = \frac{(-\frac{\beta_{2k}}{\beta_1} - \alpha_1^{priv})}{2\alpha_{4k}^{priv}} - \frac{\alpha_{3k}^{priv}}{2\alpha_{4k}^{priv}}q_j - \frac{\omega_{jk}}{2\alpha_{4k}^{priv}},$$

where  $\beta_1$  and  $\beta_{2k}$  are the estimated demand parameters.

From here, it is clear that the parameters  $\alpha_1^{priv}$  and  $\alpha_{3k}^{priv}$  can only be identified relative to  $\alpha_{4k}^{priv}$  from this equation in isolation. Further, because universities are assumed to know their heterogeneous cost for each major,  $\omega_{jk}$ , when they make their choice, the majors offered are a function of the heterogeneous cost. As enrollment,  $q_j$ , is also a function of majors offered—and therefore correlated with the heterogeneous cost—an instrument is required for enrollment. Exogenous demand-shifters are a natural choice. In practice, I use the average across markets of the exogenous portion of the enrollment utility.

Plugging this equation in to the pricing first-order condition yields the following

estimating equation:

$$\begin{aligned} & \alpha_0^{priv} - \sum_{k=1}^K \left( \frac{\beta_{2k}}{\beta_1} + \alpha_{4k}^{priv} M_{jk} \right) + 2\alpha_2^{priv} q_j + \alpha_3^{priv} q_j \mathbf{M}_j + \omega_{0j} \\ & = p_j + t_j + \psi_j + q_j \frac{\frac{\partial \bar{s}(\mathbf{S}_j)}{\partial \mathbf{S}_j}}{\left( \frac{\partial \bar{s}(\mathbf{S}_j)}{\partial \mathbf{S}_j} \frac{\partial q_j}{\partial p_j} - \frac{\partial \bar{s}(\mathbf{S}_j)}{\partial p_j} \frac{\partial q_j}{\partial \mathbf{S}_j} \right)} \end{aligned}$$

Prices are then a function of majors offered, total enrollment, and the heterogeneous marginal cost per student. Because majors and enrollment are ultimately a function of prices, and therefore of the heterogeneous cost,  $\omega_{0j}$ , instruments are required for each  $M_{jk}$  and the total enrollment. Again, I use the exogenous demand-shifters as instruments for the total enrollment. Just as with the demand-side, I use number and type of graduate programs as instruments for each of the  $k$  measures of majors offered. I claim that for each  $k$ , the corresponding measure of graduate programs is uncorrelated with the  $\omega_{0j}$  portion of the heterogeneous cost per student.<sup>1</sup>

Because the  $\alpha_3^{priv}$  can be separately identified from the other parameters in this equation, the  $\alpha_4^{priv}$  and  $\alpha_1^{priv}$  can be separated from  $\alpha_3^{priv}$  in the majors first-order condition above when the two first-order conditions are combined.

The preference for selectivity,  $\lambda_0^{priv}$ , is estimated using the first-order condition for the admission threshold, reproduced here:

$$\frac{\frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \mathbf{S}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial \mathbf{S}_j}}{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)}}{\left( \frac{\frac{\partial \mathcal{R}(p_j)}{\partial q_j} \frac{\partial q_j}{\partial \mathbf{S}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial q_j} \frac{\partial q_j}{\partial \mathbf{S}_j}}{\mathcal{R}(p_j) - \mathcal{C}(\mathbf{M}_j)} - \frac{\frac{\partial \bar{s}(\mathbf{S}_j)}{\partial \mathbf{S}_j}}{\bar{s}(\mathbf{S}_j)} \right)} = \lambda_j.$$

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<sup>1</sup>While I don't model the choice of graduate programs, the relevance of the instrument is justified in a model where there is a heterogeneous cost per graduate program that is correlated with the undergraduate major-specific heterogeneous cost,  $\omega_{jk}$ .



I use a constant and the exogenous portion of mean utility as instruments in this equation.

The identification of the preference and cost parameters for public universities follows similarly, except that an additional equation allows identification of the cost difference between in-state and out-of-state students. In Appendix D, I describe an equation that yields an expression for the heterogeneous cost for in-state students in terms of data and known demand parameters. The only instrument required in this equation is a constant (in other words, I only assume that the mean of the error term in this equation is zero).

To summarize, the supply-side parameters are identified using a system of pricing, offered major supply, and selectivity equations. This system involves several cross-equation restrictions on parameters which help to identify the parameters in the major supply equation. Since prices, majors offered, selectivity and enrollment are endogenous, I instrument for these variables using the mean of the exogenous portion of enrollment utility. In addition, I use the number and type of graduate programs as instruments for undergraduate majors offered in the pricing equation.

# Chapter 6

## Estimation

With the identification strategy outlined, I now turn to the estimation strategy and results for the admission, college choice, and supply-side parameters. In the first subsection, I describe how I simulate the individual choice sets. In subsections 6.2, 6.3 and 6.4 I describe the estimation of the admissions, demand, and supply-side parameters, following the order of the estimation routine.

### 6.1 Choice Sets

As presented in Section 4, each student may apply to any school within their choice set. In my setting, the distribution of the choice sets is both exogenous and unobserved, so I must make an assumption about these choice sets. There is a wide range of assumptions that would rationalize observed data. One potential assumption is that all students have full information and consider every university in the population. At the other extreme, I could assume every student always applies to every university in their choice set, so choice sets are indistinguishable from application

portfolios (in this case, there would be effectively no choice at the application stage). All research on the application portfolio choice problem must make some assumption about the distribution of choice sets, but the assumptions vary. Howell (2010) utilizes an approach that allows estimation of a full-information model, and Arcidiacono (2005) uses a sampling approach to select choice sets from an exogenously determined distribution.

I use an assumption that students' choice sets are limited by their state, and by random information that generates differences in choice sets across students in the same state. This assumption is most similar to the approach used by Arcidiacono (2005). I use this assumption both because I think limited information is most consistent with the institutional setting, and because it helps resolve the computational difficulty of estimating the demand-side parameters.

The computation of the applicant penetration and enrollment share functions is challenging because it involves computing the expected value of application for all possible application portfolios in each market. Furthermore, for a single application portfolio, computing the expected value of an application portfolio requires computing the probability of admission and expected value of enrollment for all possible sets of admission outcomes given each application portfolio. A brute force method under the assumption that each student chooses an application portfolio of any size and is able to choose from any university in the country would render the problem impossible to solve. In this case, the potential number of application portfolios would be over  $2^{800}$ , each with a number of possible application outcomes corresponding to the size of the application portfolio. The largest application portfolio would have over  $2^{800}$  possible admission outcomes.

Substantial computational savings are generated by limiting each student to send

a maximum of four applications. In the ELS:2002 data, which includes primarily students who would apply to college in 2004, 86% of college applicants apply to four or fewer of the four-year universities that are included in my analysis, so the assumption is not terribly restrictive.<sup>1</sup>

In Section 3.2, I described the geographic limitations on a university's market. This corresponds to a geographic limitation on each student's choice set, as students must choose from only the universities that compete in the student's state. After applying this limitation, the number of universities plausibly considered by students in each state varies, but the market with the largest number of universities has just over 150 universities competing for these students (see Appendix Figure 1). Combining this assumption with the limitation that students apply to no more than four universities still yields nearly 21 million possible portfolios in a state in which 150 universities compete.

I further limit the problem by making restrictions on the types of universities that are combined in a single application portfolio. Evidence from the individual data suggest that it is highly unlikely that students apply to, for example, three highly selective institutions (like Harvard, Yale and Stanford) and a non-selective university. To establish these results empirically, I examine patterns of selectivity in the ELS data using Barron's rankings from the 2004 *Profiles of American Colleges*.<sup>2</sup> I characterize application portfolios by the number of universities in each of six selectivity categories. I find that 95% of students' application portfolios fall in the top 74 combinations of

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<sup>1</sup>The HSLs:09 data do not record all applications sent by each student, so it is not possible to get a corresponding number for students applying to college in 2013. The best information I have from that survey says that 78% of all applicants apply to four or fewer institutions among the entire population of postsecondary institutions (including 2-year institutions and other schools not included in my analysis).

<sup>2</sup>I use ELS here instead of the HSLs:09 because the HSLs:09 only records details on up to three applications per student.

selectivity categories, so I limit the possible portfolios to follow these patterns.

After applying these restrictions, I sample 1,000 individuals per market and generate their choice sets randomly from the universities that compete in their state. These choice sets correspond to the  $\Upsilon_i$  in the model. In estimation, I assume that the choice sets include 20 universities that compete in the student's state.<sup>3</sup> There is no data to inform the likelihood of specific choice sets, but each option must be observed at least enough times that the applicant share data can be rationalized (i.e. a university that receives applications from 25% of all high school graduates must be in the consideration set for at least 25% of students). To achieve the desired properties, I weight the first seven options in the choice set by the observed share of all applications, and fill in the remaining 13 options with uniform sampling.

## 6.2 Admission Parameters

The first step in the estimation procedure is to obtain the parameters of the admission process. As outlined in Section 4.2, a student is admitted with probability:  $\Phi((s_i - \underline{s}_j)/\sigma)$ , where  $\Phi(\cdot)$  is the standard normal CDF,  $s_i$  is the student's test score (on the ACT scale), and  $\underline{s}_j$  is  $j$ 's admission threshold.

The true value of the admissions thresholds are unobserved, but a close approximation may be the observed 25th percentile of the ACT score distribution within the university. This is a very public metric that is often used in college advising to determine where a student is likely to be admitted. In estimation I use these values as the admission thresholds.<sup>4</sup>

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<sup>3</sup>In Idaho, there are fewer than 20 universities competing in the state. In this case, no sampling is necessary; instead, all students see all options available in the state.

<sup>4</sup>Another approach would be to estimate the admission thresholds by inverting the enrollment

The variance of the match value,  $\sigma$ , is estimated from the HSLs individual data by running the probit regression:

$$Accept_{ij} = \Phi((s_i - \underline{s}_j)/\sigma), \quad (6.1)$$

where the  $\underline{s}_j$  are taken from the data as discussed in the last paragraph. The results of this probit regression are shown in Table 6.1.

Table 6.1: Probit: Admissions

	coef	se
Student's Test Score - University's 25th Percentile ACT	0.150	(0.003)
Obs	12,360	
Log-Likelihood	-7,298	
Inferred Value of Sigma (1/coef)	6.653	

NOTE: This table displays the results from a probit regression of acceptance on the difference between each student's test score and the university's 25th percentile ACT score, as described in the text.

SOURCES: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, High School Longitudinal Study of 2009 (HSLs:09), Second Follow-Up. U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS), 2013 Institutional Characteristics File.

The estimated coefficient on the difference between the student's test score and the university's 25th percentile ACT is 0.150, which implies a standard deviation of  $1/0.15 = 6.653$  ACT points. This estimate suggests that factors other than the test score play an important role in the admission process.<sup>5</sup>

equation (Equation 6.3) in the estimation routine to solve for the admission thresholds that set observe enrollment equal to expected enrollment. This adds substantial computational complexity, but it is feasible for future work. This method would allow public institutions' in-state and out-of-state admission thresholds to differ.

<sup>5</sup>The estimate is sensitive to the choice of admission threshold. In the future I plan to estimate

### 6.3 College Choice Parameters

Taking the variance parameter estimated in Section 6.2 as given, I then estimate the college choice model using the simulated method of moments. The moment conditions are derived from the equations for applicant and enrollment shares derived in Section . Given a set of instruments  $Z_{jl}$ , the moment conditions derived from the applicant share equation are  $E[Z_{jl}\xi_{jl}(\theta)] = 0$ , where  $\theta$  are the demand parameters. I use the enrollment equation by setting  $E[e_j(\theta)]$  equal to the observed enrollment,  $Enroll_j$ .

These moments are stacked in a  $G \times 1$  vector:

$$g(\theta') = \begin{pmatrix} E[Z_{jl}\xi_{jl}(\theta)] \\ E[e_j(\theta) - Enroll_j] \end{pmatrix}, \quad (6.2)$$

and then the method of moments objective function is can be written as:

$$\hat{\theta} = \underset{\theta}{argmin} g(\theta)'Wg(\theta). \quad (6.3)$$

W in this objective function is a block-diagonal weighting matrix. Because the parameters are just-identified with the chosen instruments, the choice of weighting matrix does not affect the estimates.

Computing the estimates is complicated by the fact that  $\xi_{jl}(\theta)$  cannot be obtained by analytically inverting the applicant share equation. I used a nested routine that is similar to those used by Rust (1987) and Berry et al. (1995). The “outer loop” solves for the applicant cost parameters in  $\theta$ . For each guess of  $\theta$  considered in the outer loop, I find the mean enrollment utility ( $\nu_j = \beta_0 + \beta_1 p_{jl} + \beta_2 \mathbf{M}_j + \beta_3 \mathbf{X}_{j1} + \xi_{jl}$ ) that

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the admission thresholds by inverting the enrollment share equation. This poses some computational challenges but is feasible for future work.

sets the applicant share equation equal to the data. This is achieved by implementing a combination of the contraction mapping used in Berry et al. (1995) with Newton's method iterations, as in Rust (1987); Iskhakov et al. (2016).

The BLP contraction mapping in my case is:

$$\nu^{h+1} = \nu^h + \log(a(\nu^h, \theta_1)) - \log(A), \quad (6.4)$$

where the vector  $a(\nu^h, \theta_1)$  contains the model applicant shares as a function of the mean enrollment utility and the non-linear demand parameters  $\theta_1$ .  $A$  contains the applicant shares from the data, and  $h$  records the step number. Although my applicant share function is not a simple logit because of the admission and enrollment steps imbedded within it, the contraction mapping proposed by Berry et al. (1995) does converge to a solution globally, albeit slowly. Newton's method iterations, which are given by

$$\nu^{h+1} = \nu^h + [\nabla_{\nu^h} \log(a(\nu^h, \theta_1))]^{-1}(\log(a(\nu^h, \theta_1)) - \log(A)), \quad (6.5)$$

converge quite quickly, but converge locally. Therefore, I utilize BLP iterations until the model and data applicant shares are close enough for Newton's method iterations to converge. Once the  $\nu_j$  are obtained, the linear parameters  $\theta_1$  and the residuals  $\xi_{jl}(\theta)$  are found using linear IV-GMM.

The demand-side estimates are presented in Table 6.2, along with robust standard errors. For the variables that capture the number and type of major, I also show the marginal rate of substitution between the measure and price. The estimates show that students are willing to pay approximately \$136 per year for each additional



major, holding the distribution across types fixed. Majors in Engineering, Math and Science are the most valuable. Students are willing to pay approximately \$890 per year for each one percentage point increase in the share in Engineering, Math and Science relative to the excluded category, which includes Health, Education, Criminal Justice, and Other. For Business and Communications, students are willing to pay approximately \$752 per year for each one percentage point increase. For majors in Arts, Social Sciences, and Humanities, students are willing to pay approximately \$630 per year for each additional percentage point increase relative to Health, Education, Criminal Justice and Other majors.

Distance to the university is also an important factor in a student's college choice, which is not surprising given results from Long (2004b) and other studies. The effect of distance is convex—the point at which a greater distance becomes preferred is approximately 300 miles.

To give more intuition about the estimates, I present the total applications and enrollment under two counterfactuals, assuming there are no supply-side adjustments. First, I consider a drop in net price of \$1,000 at all schools. Second, I consider what would happen if all universities increased the number of majors in Engineering, Math and Science by 10% of the current level, holding other majors constant.

These simulations are presented in Table 6.3. A \$1,000 decrease in net tuition at all universities is predicted to increase the number of applications sent by 2.19%, and the number of students enrolled by 1.74%. A 10% increase in the number of Engineering, Math and Science majors at all universities is predicted to increase applications by 1.94% and enrollment by 1.57%. When the number of Engineering, Math and Science major increases, it has an effect on the proportion of majors offered in the other categories, which is why these changes do not seem as large as the estimated effects

Table 6.2: Enrollment Utility and Application Cost Estimates

	coef	se
Net Price	-0.48***	0.05
# Majors	0.06***	0.02
Arts, Soc. Sci. and Humanities (share)	30.05	21.03
Business and Comm. (share)	35.83**	17.11
Eng., Math, and Sci. (share)	42.36**	19.18
Private	-3.39***	0.95
Distance	-13.83***	1.85
Distance Sq	4.5***	0.65
Appl. Cost Constant	7.64***	0.86
Log (1+ #Applications)	19.62***	0.30
Mandatory Testing Constant	-1.63	2.25
Mandatory Testing * Log (1+ #Applications)	1.96***	0.030

NOTE: The table displays the estimated enrollment utility and application cost parameters. The cost parameters are in the bottom panel. In addition to the variables displayed here, the regression includes a constant, the 6-year completion rate, an indicator for whether the university offers a graduate program, the average room and board charge, NCES Locale Codes, Barrons Ranks, and Carnegie Size and Setting classification codes.

Table 6.3: Demand-side Simulations

Simulation	Change in Applications	Change in Enrollment
\$1,000 Decrease in Net Tuition	2.19%	1.74%
Increase Number of Engineering, Math and Science Majors by 10%	1.94%	1.57%

NOTE: The table displays the predicted changes in total applications and enrollment under two demand-side simulations, assuming no supply-side response.

relative to Health, Education, Criminal Justice and Other majors.

In the final demand-side exercise, I rank universities by the mean enrollment utility, loosely following an idea in Kapor (2016). Technically, I compute the ranking by removing all information and application frictions except for the regional market structure, and compute the share of students who would most prefer each option. The predicted ranking of universities for the top 10 is shown in Table 6.4. This simulation shows that students would generally attend a prestigious private university if they had the option. The effect of distance is reflected here in the relatively high ranking of centrally located universities, including Vanderbilt, Washington University in St. Louis, and Rice University. In other words, the reason we do not expect to see more universities from the Northeast in this list is because they are close to each other, and therefore not as valuable to students from around the country relative to a good university in a more central location.

Table 6.4: Ranking by Mean Utility

Institution Name	Rank	Avery et. al. (2013) Rank
HARVARD	1	1
VANDERBILT UNIV	2	36
STANFORD UNIV	3	5
UNIV OF CHICAGO	4	28
RICE UNIV	5	17
MASSACHUSETTS INST OF TECHNOLOGY	6	4
PRINCETON UNIV	7	6
YALE UNIV	8	3
WASHINGTON UNIV IN ST LOUIS	9	65
CALIFORNIA INST OF TECHNOLOGY	10	2

NOTE: The table displays the ranking of the top 10 universities from this model and the corresponding ranking from Avery et al. (2013).

The final column of the table compares my rankings to those proposed in Avery et al. (2013). In that paper, the authors use matriculation decisions to infer a ranking of universities, but the rankings are intentionally based on the preferences of high-performing students. The primary distinction between my method and theirs is that mine reflect average preferences among all high school graduates. My top 10 capture the top 6 from their list, but also include centrally-located universities that are substantially lower in the Avery et al. (2013) rankings. It is most likely the case that high-performing students are less concerned about distance to college, which would generate the differences between the two rankings.

In this subsection I have presented the estimates from the college choice model and have shown that these estimates produce reasonable inferences about demand-side responses. In the next subsection, I take these parameter estimates as given and estimate the supply-side model.

## 6.4 Supply-Side Parameters

The first-order conditions presented in Section 4 provide six different equations for private universities and seven for public universities, corresponding to the choice of prices (one for private and two for public universities), the total number and percentage of majors (four variables), and the admission thresholds (one variable). I use these first-order conditions to estimate the preference and cost parameters given the demand parameters discussed in the previous section.

I estimate the parameters of the model using the simulated method of moments, with moment conditions based off of the heterogeneous selectivity preference and cost. The sources of heterogeneity are the heterogeneous component of the preference

Table 6.5: Supply-Side Parameter Estimates

		(1)			(2)		
Parameter		Private		se	Public		se
$\lambda$	Selectivity Weight	0.94	***	2.91e-03	0.94	***	0.01
<i>Marginal Cost</i>							
$\alpha_0$	Constant	-52.76		33.69	-19.64	*	11.36
$\alpha_{11}$	# Majors	-0.55	**	0.25	0.13	***	2.36e-03
$\alpha_{12}$	Share Arts	62.89	***	0.34	43.41	***	4.48
$\alpha_{13}$	Share Bus.	70.22	***	0.80	72.79	***	0.98
$\alpha_{14}$	Share STEM	80.07	***	2.16	81.04	***	1.72
$\alpha_2$	q	-1.02e-04		1.50e-03	1.85e-04		2.64e-04
$\alpha_{31}$	q*# Majors	-3.73e-07		2.22e-05	-8.90e-07***		2.47e-07
$\alpha_{32}$	q*Share Arts	2.03e-04***		7.16e-05	-1.83e-04		2.30e-04
$\alpha_{33}$	q*Share Bus.	7.16e-04***		1.81e-04	4.51e-06		6.36e-05
$\alpha_{34}$	q*Share STEM	6.63e-05		2.83e-04	5.18e-04***		1.15e-04
$\alpha_{41}$	# Majors Sq.	6.65e-03**		2.70e-03	5.21e-05**		2.52e-05
$\alpha_{42}$	Share Arts Sq	0.99	**	0.40	27.31	***	6.33
$\alpha_{43}$	Share Bus. Sq	15.45	***	2.37	9.45	***	3.10
$\alpha_{44}$	Share STEM Sq	23.12	***	6.37	14.05	***	3.71
$\alpha_6$	In-State Student				-11.62	***	0.02
Obs.		466			428		

NOTE: The table displays the estimated supply-side parameters computed using a GMM objective function as described in the text. Controls for the completion rate and Barron's ranks are included but not shown.

for selectivity ( $\epsilon^s(\theta^s)$ ), and the heterogeneous marginal cost per student,  $\omega_j$ . The heterogenous cost is decomposed into a constant and a heterogeneous cost for the number and each type of major. The moment conditions are  $E[Z_{0j}^s \omega_{0j}(\theta^s)] = 0$ ,  $E[Z_{kj}^s \omega_{kj}(\theta^s)] \forall k$ , and  $E[Z_{K+1,j}^s \epsilon^s(\theta^s)] = 0$ , where  $Z^s$  is a set of instrumental variables for each equation, and  $\theta^s$  are the supply-side parameters. Instruments are as discussed in Section 5.

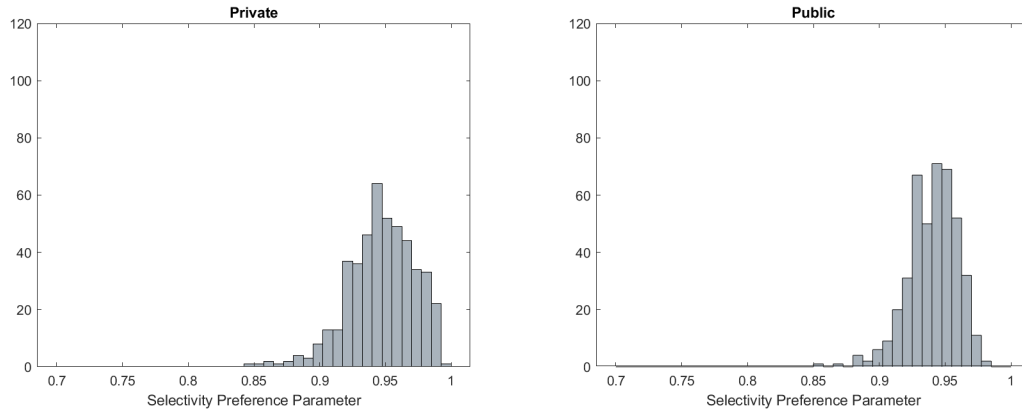
The estimates from this regression are shown in Table 6.5. The selectivity pref-

erence parameter is high, at 0.94 for both public and private universities. From this I conclude that a net-revenue maximizing framework does not characterize well the behavior of universities, at least in the context of this static model.

The marginal cost parameters are in many respects quite similar between public and private universities. For public universities, the parameter on in-state students suggests that an in-state student is valued at approximately \$11,500 dollars more than an out-of-state students. This difference reflects government preferences that are internalized by the public universities through legislative mandates and appropriations, to the extent that appropriations are tied to the share of in-state students.

The estimated cost parameters imply a distribution of university preference for selectivity, as captured by the heterogeneous Cobb-Douglas parameter  $\lambda_j$ . This distribution is shown in Figure 6.1. There is not a great deal of heterogeneity in the Cobb-Douglas parameter, which means that controls in the cost function and differences in revenue and demand are helping to explain observed variation in selectivity.

Figure 6.1: Distribution of Preference for Selectivity



NOTE: This figure shows the distribution of the estimated selectivity preference parameter among public and private universities.

## Chapter 7

# Counterfactual Simulations

The estimated model allows for the analysis of equilibrium adjustments to prices, selectivity, and majors offered in response to a variety of counterfactuals. I use this model to study the effects of subsidies in the form of financial aid and direct subsidies for universities to provide Engineering, Math and Science majors. For each counterfactual, I describe the equilibrium adjustments to prices, selectivity and majors offered, and enrollment.

### 7.1 Financial Aid

My first counterfactual simulation examines a financial aid policy at a state level. Specifically, in this counterfactual the state of Wisconsin introduces a \$1,000 grant for all Wisconsin residents to attend a public university in the state.<sup>1</sup> I show how a complex supply-side reaction develops, notably resulting in increased selectivity

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<sup>1</sup>I use as an example the state of Wisconsin, but there is nothing in the model that restricts me to study Wisconsin alone. In the future, I can run similar counterfactuals for other states or even the entire nation.

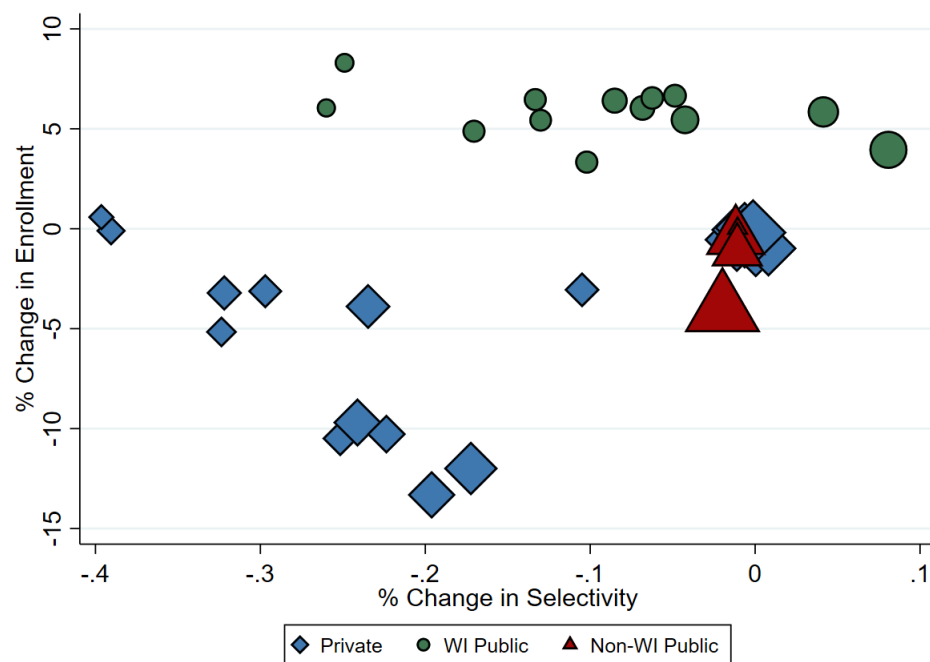
stratification in the public sector and a more selective private sector.

As a starting point, it is useful to understand how such a policy would affect selectivity and enrollment at each university if we assumed that there would be no supply-side response. This is illustrated in Figure 7.1. Public in-state universities—shown in green circles—see a positive change either in enrollment or in selectivity. Markers in the graph are sized by selectivity prior to the introduction of the grant. The two public universities with the highest selectivity—the University of Wisconsin-Madison and the University of Wisconsin-La Crosse—see a positive change in their selectivity because they now enroll students who otherwise would have gone to a selective private or an out-of-state public university. Other public universities see a net decrease in their selectivity, because they now enroll more students who would either not have attended a university at all, or would have attended a less selective public or private university.

Private and public out-of-state universities typically experience reduced selectivity and enrollment as a result of the policy, with some private universities losing nearly 15% of their total enrollment. However, it is possible for some private or public out-of-state universities to experience either increased enrollment or increased selectivity. A selective private university loses enrollment primarily from marginal students who now find it optimal to apply to a public university. Meanwhile, a less selective private university may gain students due to complementarities in the application process. A student who was on the margin of applying to college but chose not to apply may now choose to apply after the aid is introduced because the public universities are now more attractive. Because the student now applies to the public university, they may find it optimal to apply to a less selective private university as well, because the marginal cost of the second application is lower than the marginal cost of the first.



Figure 7.1: Change in Selectivity and Enrollment with No Equilibrium Response



NOTE: The graph shows the change in selectivity and enrollment among the 44 universities that compete directly for students in Wisconsin when a \$1,000 scholarship is introduced for Wisconsin students to attend Wisconsin public universities, assuming no supply-side response. Private universities are shown in blue diamonds, Wisconsin public universities in green circles, and non-Wisconsin public universities are shown in red triangles. The markers are weighted by selectivity prior to the introduction of the grant.

Many of these new applicants may be admitted only to the private university, so the private university gains enrollment from these marginal applicants.

The simulation considered so far assumes no supply-side response, but universities do in fact have the chance to respond in order to balance revenue and selectivity. As a result of the increase in financial aid and corresponding increase in demand, public universities' prices, admission thresholds, and majors offered will adjust. The model also implies that private universities and public out-of-state universities will respond because the policy and their public competitors' responses affect their demand.

Further, the state-level policy would induce responses by every university throughout the U.S. through the chain-linked competition implied by the regional span of each university's enrollment. For example, although the University of Virginia does not compete directly for students in Wisconsin, the University of Chicago, the University of Notre Dame, and Washington University in St. Louis all compete in Virginia and Wisconsin, so the University of Virginia will adjust to changes at these three competitor universities. Because overlaps of this type exist across all states, equilibrium will involve Nash responses among all universities in the nation. However, because the equilibrium calculations are time-intensive, I shut down indirect responses through chain-linked competition in this version of the counterfactual simulations; I only allow adjustments by universities that directly compete for Wisconsin students.<sup>2</sup> The Nash equilibrium is computed using iterated best-response.

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<sup>2</sup>In future work, I will analyze how a single state's policy reverberates through the chain of competition by allowing all universities to respond.

Table 7.1: Counterfactual Response to a \$1,000 Scholarship for Wisconsin Public Universities

Response	Type	Statistic	N	Percent Change in:							
				OOS Price	IS Price	Admission Threshold	# majors	Ma-	Arts, Sci. Hum.	Soc. and	Business and Comm.
Prices	Non-WI Public	p25	4	0.95	-1.20						
		p50	4	3.28	-0.49						
		p75	4	8.00	-0.05						
	WI Public	p25	13	-1.54	-0.97						
		p50	13	-0.78	-0.56						
		p75	13	0.63	0.31						
	Private	p25	27	-0.04							
		p50	27	0.01							
		p75	27	3.95							
Prices, Admission Threshold	Non-WI Public	p25	4	-0.49	-2.51	-0.23					
		p50	4	1.37	-0.56	0.01					
		p75	4	6.09	-0.31	0.03					
	WI Public	p25	13	-2.69	-3.84	-1.24					
		p50	13	-0.01	-1.29	-0.42					
		p75	13	1.13	-1.17	0.10					
	Private	p25	27	-0.27		-0.17					
		p50	27	0.02		0.01					
		p75	27	20.86		6.45					
Prices, Admission Threshold, Majors	Non-WI Public	p25	4	0.52	-7.37	-0.13	-0.01		-0.50	-2.36	-0.62
		p50	4	1.07	-4.84	0.00	0.00		-0.37	-1.51	-0.21
		p75	4	3.48	-1.20	0.07	0.00		-0.07	-0.19	0.96
	WI Public	p25	13	-7.68	-1.56	-1.06	0.00		0.22	0.04	-2.36
		p50	13	0.31	0.10	-0.20	0.02		0.39	0.98	-1.22
		p75	13	1.07	0.39	0.26	0.08		0.59	2.83	-0.93
	Private	p25	27	-0.07		-0.05	0.00		-4.63	-0.96	-0.80
		p50	27	0.00		0.10	0.01		-0.68	0.26	-0.11
		p75	27	15.94		5.94	0.04		0.03	2.40	0.28

NOTE: The table displays the counterfactual responses of Wisconsin public, non-Wisconsin public, and private universities competing for Wisconsin students when in-state students are given \$1,000 to attend public universities. Columns show the percentage change in the out-of-state price, the in-state price, the admission threshold, the number of majors offered, and the share of the universities' majors offered in each listed category.

Table 7.2: Gradient of Price-Only Counterfactual Adjustment with Respect to the Initial Admission Threshold

	(1) OOS Price	(2) IS Price
Private	-0.380	
WI Public	0.535	0.412
Non-WI Public	-0.675	0.125
Observations	38	17
R-squared	0.460	0.148

NOTE: The table shows the linear regression coefficient from a regression of the counterfactual percentage change in out-of-state (OOS) and in-state prices (IS) on the observed admission threshold prior to the counterfactual introduction of financial aid. It includes fixed effects for each university type. For private universities, the column with the OOS price represents the private university's net tuition. Of the 44 universities in this counterfactual, 38 are private or are public and compete out-of-state, and all 17 public universities compete with an in-state price.

Table 7.1 shows the counterfactual changes in prices, selectivity and majors offered in response to the grant offered at public universities. The results are broken down into three different assumptions about the endogenous variables. First only prices are allowed to be flexible, then prices and admission thresholds, and finally, prices, admission thresholds, and the number and type of majors offered. For each simulation, the table shows the 25th, 50th and 75th percentile responses for private, public in-state and public out-of-state universities.

Each simulation evidences notable heterogeneity in the response of price, admission selectivity and the number and type of major. The direction and magnitude of each university's response is largely determined by the university's place in the

selectivity distribution.<sup>3</sup> Thus, in addition to presenting the percentiles in Table 7.1, I present the simple regression coefficients from a regression of the counterfactual adjustment on the observed (pre-counterfactual) admission threshold for each set of counterfactuals.

If universities are only able to change prices, non-Wisconsin public universities raise their prices on the Wisconsin students and reduce their in-state prices. They are less competitive in Wisconsin so they focus on maintaining enrollment from in-state students. Most Wisconsin public universities increase prices for in-state students, and most reduce prices for out-of-state students. More selective Wisconsin public universities generally raise their prices, while less selective universities reduce their prices and focus on increased enrollment. The model predicts a substantial enrollment expansion (about 10%) at the least selective public university. For private universities, the price response is negatively correlated with selectivity. The correlations described here between the price responses and the observed admission threshold prior to the counterfactual policy are summarized in Table 7.2.

In the second set of simulations, universities may change both prices and selectivity levels. The price responses are amplified relative to those observed when universities can only change their prices, and admission thresholds increase at some universities and decrease at others. Among public universities in Wisconsin, universities become increasingly stratified by selectivity. The University of Wisconsin-Madison and several

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<sup>3</sup>Each university's place in the selectivity distribution in turn is largely determined by the characteristics that I treat as exogenous, including the distance to each state, the Barron's rank, graduation rate, Carnegie Classification for size and setting, and on the supply-side, the exogenous sources of revenue. Some measures of academic quality, such as the Barron's rank, are not in fact fixed and might change with a significant policy intervention (for example, redistributing endowments). However, the market has exhibited a strong tendency towards maintaining the observed ordering of universities with respect to quality and selectivity. The Barron's rank and other measures of quality preserve this ordering in my counterfactuals.

others increase their admissions selectivity, and the University of Wisconsin-Superior and University of Wisconsin-Parkside are predicted to have the greatest declines in selectivity. Nearly all private universities increase their selectivity levels. They can no longer compete as well for the bottom end of the distribution of students, so they choose to become more selective and to price higher, focusing on the subset of the market that has a strong idiosyncratic preference for attending their university.

Table 7.3: Gradient of Price and Admissions Counterfactual Adjustment with Respect to the Initial Admission Threshold

	(1) OOS Price	(2) IS Price	(3) Admission Threshold
Private	-5.058		-0.793
WI Public	2.261	5.456	1.208
Non-WI Public	-0.383	0.509	0.055
Observations	38	17	44
R-squared	0.110	0.171	0.197

NOTE: The table shows the linear regression coefficient from a regression of the counterfactual percentage change in out-of-state (OOS) and in-state (IS) prices and the admission threshold on the observed admission threshold prior to the counterfactual introduction of financial aid. For private universities, the column with the OS price represents the private university's net tuition. Of the 44 universities in this counterfactual, 38 are private or are public and compete out-of-state, and all 17 public universities compete with an in-state price.

In the final simulation, I allow prices, admission thresholds, and the number of majors offered at private universities to respond. Now, universities can cut costs by adjusting the number and type of majors offered. In general, the share of majors offered in Engineering, Math, and Science declines at public universities, and the share in the Arts, Humanities and Social Sciences increases. While the change in the

total number of majors is small, changes in the type of major are more substantial. In general, universities now make smaller adjustments to prices and admission thresholds than when the majors offered were fixed.<sup>4</sup>

The final counterfactual simulations depend critically on the exact shape of the cost function and the assumptions about the demand response, so predictions should be interpreted with caution. In the final section of this paper, I describe some future improvements that will make the counterfactuals more rich and precise.

So far the summary of results has focused on equilibrium prices, admissions selectivity, and majors offered, but ultimately the effects are reflected in total enrollment. Before allowing for a supply-side response, the change in the total model-predicted enrollment due to the new financial aid is small: approximately 0.8%. However, the full model predicts that the least selective public in-state universities will reduce their admission thresholds, resulting in a substantial enrollment expansion at the least selective universities. Primarily because of the admissions mechanism, the model predicts a total enrollment increase of nearly 5%.

To benchmark my findings against the effects of existing aid programs, I look to the work on the effects of the Georgia HOPE (“Helping Outstanding Pupils Educationally”) program. The state of Georgia introduced the HOPE program in 1993 to boost in-state enrollment and reward academic achievement. For most of its history, the program provided full tuition, fees, and book expenses for all eligible students who attended an in-state four-year public university, and a comparable amount for students who attended an in-state four-year private university. To be eligible, students would need a B average or higher in high school. The program also provided

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<sup>4</sup>The exception is among non-Wisconsin public universities, a finding which will likely be altered if universities competing in other markets are also allowed to adjust.

money for trade and two-year schools with no income restrictions or merit requirement. While the majority of states have implemented some merit aid program in the last three decades, Georgia's was one of the earliest and it continues to be one of the most generous state merit aid programs (Sjoquist and Winters, 2016). Thus, it provides the most fitting comparison for my counterfactual policy.

Georgia's HOPE program had a substantial positive enrollment effect. Cornwell et al. (2006) find that enrollment increased by 9% at four-year public universities and 13% at four-year private universities as a result of the program. The estimated total enrollment effect (including 2-year schools) was 5.9%. Dynarski (2000) used different data and found a total enrollment increase of approximately 25% including 2-year schools. Cornwell et al. (2006) suggest that the differences between the estimates are driven at least in part by the behavior of students who delayed college entry.

My estimates for a counterfactual aid program in Wisconsin are not directly comparable, as this counterfactual program has no grade requirement and is not applicable to private schools. However, my estimate of a 5% increase in in-state four-year enrollment as a result of this program is not that different from the estimates in Cornwell et al. (2006) when you take into account that my counterfactual aid amount per student is approximately half of the average amount awarded under Georgia's HOPE program.<sup>5</sup>

The Georgia HOPE program also affected prices. Long (2004a) shows that public universities did not change tuition in response to Georgia HOPE (but did raise room and board), and that private universities increased their tuition charges. My coun-

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<sup>5</sup>This suggests that the merit requirement doesn't change the outcome that much, consistent with the fact that, typically, over 50% of Georgia high school graduates qualified for the award in early years of the program. The remaining students are less likely to meet admission requirements and therefore may be unaffected by a scholarship to a four-year university anyway.



terfactual suggests that highly selective public institutions would raise their tuition and absorb some of the aid money, but less selective public institutions reduce their tuition. Because of the small number of institutions involved, Long (2004a) is not able to study differential responses by selectivity level. My findings suggest that the average effects in Long (2004a) obscure some important sources of heterogeneity.

Finally, Cornwell and Mustard (2006) shows that the Georgia HOPE program created a greater degree of stratification, with more selective colleges seeing increases in the average student SAT and less selective colleges seeing decreases in the average student SAT. These findings mirror my predictions for public institutions when a financial aid program applies only to public universities.

Overall, the existing evidence on Georgia's state merit aid program lends credence to my findings in the financial aid counterfactual. One advantage of the structural model is that it allows me to extend the literature on state aid programs by predicting the effects of counterfactual programs in different states with different award amounts and requirements.

The main finding that we can take from this first counterfactual is that a policy that supports students directly in an effort to reduce the cost of tuition will cause equilibrium adjustments on a number of margins. In this simulation, financial aid offered to students to attend in-state public universities generates increased price and selectivity stratification among public universities. In this paper, I also highlight that—in addition to price and selectivity adjustments—universities may pursue quality adjustments in the form of changes to offered programs.

## 7.2 Subsidies for Engineering, Math, and Science

In 2012, the President’s Council of Advisors on Science and Technology stated that the U.S. would need “approximately 1 million more STEM professionals than the U.S. will produce at the current rate over the next decade if the U.S. is to retain its historical preeminence in science and technology” (President’s Council of Advisors on Science and Technology, 2012). Federal and state government interest in promoting STEM is evidenced by existing programs to encourage STEM education. At the federal level, there is a loan forgiveness program that rewards teachers who meet certain requirements, and the program is most generous for science and math teachers (Federal Student Aid, 2018). There are also many state-level programs designed to encourage STEM at the postsecondary level. The New York State STEM Incentive Program provides grant aid for students who study in a STEM field at a New York public or private university and meet additional requirements (Higher Education Services Corporation, 2019). Maine’s Educational Opportunity Tax Credit—which provides assistance with loan payments for college graduates that live and work in the state—is more generous for STEM degrees (Maine Revenue Services, 2019).<sup>6</sup> New Jersey recently passed legislation introducing a loan forgiveness program for college graduates with STEM degrees (State of New Jersey Office of the Governor, 2018).

Another way to incentivize STEM education at the postsecondary level would be for the government to give universities additional subsidies to support STEM programs. In this second counterfactual, I consider the effects of such a subsidy. Again, for computational convenience, I limit to universities that compete for students in Wisconsin. In the counterfactual, public universities receive a subsidy award of

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<sup>6</sup>For students with STEM degrees, the tax credit is refundable.

\$10 per student for each Engineering, Science, and Math program offered.<sup>78</sup>

Table 7.4 displays the results from this counterfactual. Just as in the financial aid counterfactual, I allow only prices to respond, then prices and admission thresholds, and finally prices, admission thresholds and offered majors.

When universities can change only prices and admission thresholds, Wisconsin public universities choose to increase enrollment by reducing prices and reducing admission thresholds. Just as in the financial aid counterfactual, some private universities lose out substantially when the public universities are subsidized. These universities raise their prices and admission thresholds.

When universities can also adjust majors, public universities clearly have an incentive to increase the number of majors offered in Engineering, Math and Science. The median increase in the share of majors in Engineering, Math, and Science is over 11%, and the median increase in the total number of majors offered is over 22%. Translating to levels instead of share, the median number of Engineering, Math, and Science majors offered at public universities increases from 8 to nearly 12. As Wisconsin public universities increase the number of majors they offer in Engineering, Math, and Science, they become more attractive to students. Most public universities are able to leverage this additional market power to increase prices. Just as in the financial aid counterfactual, the selectivity differences between the most- and least-selective universities are amplified.

Most private universities don't change their prices, selectivity, or majors offered

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<sup>7</sup>This per-student/program award translates to a total award ranging from \$4,000 to \$3,000,000 for the first-year class at each university based on existing enrollments and program offerings.

<sup>8</sup>The Engineering, Science, and Math category in my analysis captures most majors at the four-year level that are typically included in STEM, although there are some more vocational or technical programs that are typically included in STEM that are classified as "Other" in this analysis and are therefore not rewarded in this policy counterfactual.

substantially, except that some of the least selective private universities are again unable to compete for students with low test scores and choose to raise their prices and admissions selectivity. The 75th percentile change in price among private universities is 17%, and the 75th percentile change in the admissions threshold is 11%.

Although many universities become more selective, the total enrollment effect of the subsidy is to increase enrollment by 4.4%. The students who are pushed out due to the increased admissions selectivity at some public and private universities are absorbed by several broad-access public universities. In addition, more students who otherwise would not attend college are accepted by the broad-access institutions.

The counterfactuals explored in this section have demonstrated that subsidies—both in the form of financial aid and direct subsidies to universities to support Engineering, Science, and Math programs—have important implications for prices, admissions selectivity, and program offerings at universities. The substantial heterogeneity in the supply-side response is an important feature of the findings. In particular, the most selective public universities gain the most leverage from a subsidy to public universities, and are able to increase average prices and selectivity. This leaves the public broad-access universities to enroll the marginal students who either did not attend college in absence of the subsidy, or who are no longer accepted to a private or more selective public university because these universities now have higher admission standards.

Table 7.4: Counterfactual Response to an Engineering, Science, and Math Subsidy at Wisconsin Public Universities

Response	Type	Statistic	N	Percent Change in:						
				OOS Price	IS Price	Admission Threshold	# Majors	Arts, Sci. Hum.	Soc. and Business and Comm.	Eng., Math, and Sci.
Prices	Non-WI Public	p25	4	0.00	-0.13					
		p50	4	0.00	0.00					
		p75	4	0.00	0.00					
	WI Public	p25	13	-0.97	-1.62					
		p50	13	-0.59	-1.43					
		p75	13	-0.51	-1.27					
	Private	p25	27	0.00						
		p50	27	0.04						
		p75	27	0.32						
Prices, Admission Threshold	Non-WI Public	p25	4	-1.91	-1.82	-0.28				
		p50	4	-0.28	-0.04	-0.09				
		p75	4	-0.06	0.26	-0.04				
	WI Public	p25	13	-1.15	-3.78	-0.77				
		p50	13	-0.82	-2.62	-0.39				
		p75	13	-0.38	-2.03	-0.18				
	Private	p25	27	-0.22		-0.11				
		p50	27	0.00		0.00				
		p75	27	22.32		11.10				
Prices, Admission Threshold, Majors	Non-WI Public	p25	4	-0.46	-0.51	-0.13	0.00		-0.07	-0.60
		p50	4	-0.20	0.46	0.01	0.00		0.02	-0.10
		p75	4	0.27	1.22	0.02	0.00		0.09	0.37
	WI Public	p25	13	15.47	47.12	-1.21	18.42		-0.13	-1.52
		p50	13	20.27	54.04	-0.23	22.46		0.11	-0.63
		p75	13	25.32	83.60	-0.07	46.85		0.23	0.11
	Private	p25	27	-0.13		-0.11	0.00		-4.34	-0.12
		p50	27	0.00		0.04	0.02		-0.29	0.22
		p75	27	17.33		10.84	0.05		0.02	2.51

NOTE: The table displays the counterfactual responses of Wisconsin public, non-Wisconsin public, and private universities competing for Wisconsin students when public universities are subsidized at a rate of \$10 per student for each undergraduate major offered in Engineering, Math, and Science. Columns show the percentage change in the out-of-state price, the in-state price, the admission threshold, the number of majors offered, and the share of the universities' majors offered in each listed category.

## Chapter 8

### Conclusions

Despite notable advances in modeling the U.S. higher education market, there is much more to be done. This market is difficult to study because of the decentralized admission process and the non-profit nature of both public and private universities, which together introduce both conceptual and computational challenges. This paper furthers an understanding of this market through a model of oligopoly with differentiated universities. In the model, universities set prices, admissions selectivity, and offered majors in a strategic environment.

The model of college choice demonstrates that students value majors offered at approximately \$136 on average, with substantial heterogeneity by type. Engineering, Math, and Science majors are valued the most, followed by Business and Communications, then Arts, Social Science, and Humanities. On the supply-side, I show that costs differ by type of major, with Engineering, Math, and Science most expensive to offer initially, but with costs increasing in enrollment at a slower pace than the other types of majors. The results also show that university behavior on a static basis is not well characterized by a profit-maximizing framework; universities give up revenue

in order to increase their selectivity when they choose their admission threshold.

In the first policy simulation, I consider the effect of increased financial aid offered to students who attend in-state public universities. As an example of this type of policy, I simulate a \$1,000 grant offered to Wisconsin students to attend public universities in their state. The results show that public universities become increasingly stratified by selectivity and price, with the least selective universities reducing their admission selectivity and price, and the most selective universities increasing their admission selectivity and price. Private universities become more expensive and more selective, as they are less able to attract students with low test scores away from the broad-access public universities. Changes to majors offered allow all universities to adjust their costs, and these changes tend to moderate the effects of the policy on prices and admissions selectivity.

A second policy simulation considers the effect of subsidizing majors offered in Engineering, Math, and Science. When public universities in Wisconsin are offered \$10 per student per major offered in Engineering, Math, and Science, the median number of Engineering, Math, and Science majors offered at each public university increases from 8 to 12. This is accompanied by large increases in prices at most public universities and increasing selectivity and price stratification. Less selective private universities respond by raising prices and admission selectivity, focusing on the narrow slice of the market with a strong idiosyncratic preference for their institution.

The results should be interpreted with some caution, as there are a number of limitations that may affect the estimates and counterfactual responses. Importantly, this model does not allow for exit, although many of the small private universities are substantially adversely affected by the counterfactual policies considered here. While this model predicts that they would become more selective (and as a result, enroll

very few students), they may instead close altogether. A model of college exit is an interesting direction for additional research, especially as recent demographic changes and market factors have led to substantial enrollment declines at many colleges and universities.

There are several feasible extensions to the current model that would make counterfactual predictions richer and more precise. In the following paragraphs I highlight a number of directions for future work.

It is clear from summary data released by the College Board and ACT that test scores are correlated with student's intended major as indicated when they take the SAT or ACT. This motivates an interaction between the student's test score and their preference for certain types of majors.<sup>1</sup> If this interaction was incorporated on the demand-side, this would imply that a university could modify its program offerings to attract certain types of students. Instead of the admission threshold only affecting expected applications and enrollment through the admission probability, it would also affect the utility derived from the offered majors among likely enrollees. It is feasible to include such an interaction in the enrollment utility although it would impose some additional computational burden.<sup>2</sup>

Some other potential improvements involve a more nuanced treatment of prices and the admission process. Using data on the income distribution by state and average net price by income group, I can also simulate prices that vary with income. Admissions is currently independent across universities within individual, but a more realistic generalization would be to allow for the presence of student-specific fixed

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<sup>1</sup>A similar interaction is included in Arcidiacono (2005) and turns out to be important in that model.

<sup>2</sup>An even more thorough approach to modeling the effect of majors on demand would be to model the choice of college major as a fifth stage appended to the current framework. I see this as an important direction for future work.



effects that are common across universities.

Another area for future work deals with the admission thresholds. In the current estimation, admission thresholds are taken from the data. I assume that the observed 25th percentile ACT score among each university's enrollees is equivalent to the admission threshold in the model. Another way to obtain the admission thresholds would be to estimate them in the demand-side routine by inverting the enrollment equation for the admission threshold. Then the admission threshold would be the value that sets observed enrollment equal to the model expected enrollment for each university, given the other demand parameters. This method would be advantageous because it would allow for public universities to have different in-state and out-of-state admission criteria, and would not rely on a crude proxy for the admission thresholds. Conceptually this is not challenging, but practically it involves computing the solution to over 800 additional equations for each iteration of the GMM minimization routine. Finding an estimation routine that allows recovery of the admission thresholds within the model is an interesting direction for future research.

While there is still work to be done, this research has made a significant step towards understanding the importance of competition and market structure in the U.S. higher education market. I demonstrate that there is substantial variation among universities in the number and type of majors that are offered, and that this variation has implications for college choice. Counterfactual simulations point to the importance of different assumptions about the nature of the supply-side response. Therefore, analysis of higher education policy should thoughtfully address how market mechanisms affect the interpretation of results.

## Chapter 9

# Appendices

### 9.1 Estimating the Test Score Distribution

Data from the ACT and SAT tests provides the distribution of test scores among test-takers. Estimation of the model requires the distribution of scores among the entire population of high school graduates. To obtain the counterfactual score distribution as if all students took an admission test, I utilize variation by state over time in the existence of universal (or mandatory) college admission testing policies.

Since 2001, a growing number of states have adopted mandatory college admission testing policies, which require students to take an ACT or SAT test prior to high school graduation. There is a growing literature devoted to documenting the effects of these policies on testing participation and college enrollment (Hurwitz et al., 2015; Hyman, 2017; Cook and Turner, 2019). The most critical—though unsurprising—empirical point is that on average, students who choose not to take a test when it is voluntary have lower scores on average than students who would voluntarily take the test. Thus, I cannot assume that the score distribution among test-takers is, in

general, the same as the distribution among all high school graduates.

In states with mandatory testing, I can use the distribution among test-takers because all high school graduates are required to take the test.<sup>1</sup> In the other states, I predict the average score and then assume the score distribution is normal with a standard deviation equal to the national standard deviation.

To predict the average score, I first combine ACT and SAT data on test scores by state. I utilize tables provided by ACT and College Board to convert SAT scores to ACT scores. I utilize ten years of data for this exercise (2006-2015), which gives me 510 observations for the 50 states plus D.C. over ten years. Then I estimate the following regression to predict average scores, where  $l$  is state and  $t$  is the year, and  $Mand\_Test_{lt}$  is an indicator for whether the state  $l$  had a mandatory testing policy in year  $t$ :

$$avgscore_{lt} = \beta_1 Mand\_Test_{lt} + \delta_l + \nu_l t + \epsilon_{lt}.$$

The estimates from this regression show that a mandatory testing policy reduces the average score by 1.327 ACT points. I predict the average score under mandatory testing for all states. Then the distribution of scores is a normal distribution centered around the predicted values, with a standard deviation equal to the national standard deviation of ACT scores.

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<sup>1</sup>Opt-out is limited. Typically participation rates are above 95% in these states.

## 9.2 A Simplified Model of College Choice

The most basic question in this research is whether net tuition, majors offered, and admissions selectivity affect a student's choice of college. In this section, I answer this question in isolation by regressing measures of college choice (based on applications and enrollment) on variables affecting a student's choice of college. This presentation will introduce some variables and notation used in the structural model, and will preview the identification strategy.

### 9.2.1 Model

First, I define some notation, which is consistent with notation used in the structural model. Let  $l = 1 \dots L$  denote the high school graduate's state of residence. There are  $J + 1$  universities  $j = 0, 1, \dots, J$ , where  $j = 0$  represents the outside option of four-year colleges not included here (such as for-profit universities), two-year colleges, other educational certificate programs, the labor market, or other options. Each university offers a number of majors within each of  $K$  broad categories. Let  $\mathbf{M}_j$  be a  $K \times 1$  vector where the first element,  $M_{j1}$  is the total number of majors university  $j$  offers, and the remaining  $K - 1$  elements are the proportion of majors in each group (with Health, Education, and Other the excluded category). Universities also have a number of exogenous characteristics,  $\mathbf{X}_{jl}$ , such as whether the university is under private or public control and the distance to the population center of each state. Universities charge a net tuition,  $p_{jl}$ , which is tuition minus average grants and aid. For private universities, this price will be constant across  $l$ , while for public universities, the price varies by in-state status (whether  $l$  is the state where  $j$  is located).

Universities also have admissions criteria, which determine how difficult it is for a student to gain admission. The likelihood of admission is likely an important consideration when students choose where to apply — since applications are costly, a student will not apply to a university if he has very little chance of admission. The likelihood of admission also mechanically reduces enrollment, so it is important to control for this factor when explaining enrollment. I use the observed 25th percentile of ACT scores among entering freshmen at each university as an index of admission difficulty, and I call this  $\underline{s}_j$ . In the structural model,  $\underline{s}_j$  takes on a more precise meaning as an admission threshold on a student-university match value.

The first dependent variable in this simplified model is constructed from applications: the natural logarithm of the ratio of university  $j$ 's share of applications from state  $l$  to the share of students from state  $l$  who sent no application ( $j = 0$ ) (notated  $\ln(applicationshare_{jl}/applicationshare_{0l})$ ). This dependent variable can be motivated in two ways. First, one can think of this simply as a sensible alternative to using the number of applications to each university by state. Using shares is more appealing than just the number of applications because the shares account for the fact that some states graduate more students than others. Dividing by the share of students who do not apply to any university and taking logs generates a dependent variable that can take any real value, making it an appropriate dependent variable for a linear combination of explanatory variables.

A second way to motivate this dependent variable is to derive it from a logit demand system as in Berry (1994), with some ad hoc assumptions. First, we must assume that each application can be viewed as arising from a completely independent decision (as if each application corresponded to a separate student), where each application represents a single discrete choice. Second, we must assume admissions

selectivity enters linearly into utility, as do prices and other characteristics. Then we can write the utility function as:

$$u_{ijl} = \beta_0 + \beta_1 p_{jl} + \beta_2 \mathbf{M}_j + \beta_3 \mathbf{X}_{jl} + \beta_4 \mathbb{S}_j + \xi_{jl} + \eta_{ijl}. \quad (9.1)$$

This utility function includes a student-university specific unobservable,  $\eta_{ijl}$ , which is distributed Type I Extreme Value, and a university-market specific unobservable  $\xi_{jl}$ .

Let  $\nu_{jl} = u_{ijl} - \eta_{ijl}$  and normalize  $\nu_{0l} = 0$ . Then the application share can be written as:

$$applicationshare_{jl} = \frac{e^{\nu_{jl}}}{1 + \sum_{j'=1}^J e^{\nu_{j'l}}}. \quad (9.2)$$

Now the regression equation can be found by dividing the application shares by the share of students who do not apply to college:

$$\ln \left( \frac{applicationshare_{jl}}{applicationshare_{0l}} \right) = \nu_{jl} = \beta_0 + \beta_1 p_{jl} + \beta_2 \mathbf{M}_j + \beta_3 \mathbf{X}_{jl} + \beta_4 \mathbb{S}_j + \xi_{jl}. \quad (9.3)$$

I also run a similar regression with a dependent variable based on enrollment on the left-hand side. In this case, the assumption that each student choose only one university to attend is not concerning. However, this model does not take into account how the application stage affects the enrollment share. The regression equation in this case is:

$$\ln \left( \frac{enrollments_{jl}}{enrollments_{0l}} \right) = \nu_{jl} = \beta_0 + \beta_1 p_{jl} + \beta_2 \mathbf{M}_j + \beta_3 \mathbf{X}_{jl} + \beta_4 \mathbb{S}_j + \xi_{jl}. \quad (9.4)$$

### 9.2.2 Identification and Estimation

The regression equations derived above can be estimated via OLS. However, if students and universities know the unobservable  $\xi_{jl}$ , and universities choose prices, majors, and admissions selectivity knowing that students will respond, then prices, majors, and admissions selectivity are correlated with  $\xi_{jl}$ . This is the classic endogeneity problem that is considered in Berry et al. (1995) and in related literature. Appropriate instruments can be used with a two-stage least squares estimation routine to obtain consistent estimates. The instruments I utilize in the regressions presented below are: 1) an indicator for public in-state status, 2) the average number of competitors faced by university  $j$  in its markets, and 3) the number and type of graduate programs the university offers, measured in the same way as the undergraduate majors.

The first-stage regressions are summarized in Table 9.1. As seen in the first column, the in-state public indicator is the main instrument responsible for the identification of the price coefficient. In other words, the price coefficient is identified primarily by comparing how in-state and out-of-state application or enrollment shares vary with the differences in in-state and out-of-state prices, for public institutions. The underlying assumption is that the only reason a student goes to an in-state public university instead of another university with the same observable characteristics (including the same location) is the difference in prices.

The second column in Table 9.1 shows that several of the instruments are correlated with the 25th percentile ACT score. Columns 3-7 demonstrate that graduate programs are positively correlated with undergraduate programs, both in total number and within type. Graduate programs are only valid instruments for undergraduate programs if they are also uncorrelated with the demand-side unobservable for

undergraduates. I assume that the graduate and undergraduate program decisions are independent, but that common drivers on the cost side produce the observed correlations. A more thorough explanation is found in Section 5.



Table 9.1: First-Stage Results for 2SLS Estimation of Equation 9.3

	(1) Average Net Tu- ition	(2) 25th Per- centile ACT	(3) Number of Majors	(4) Share Arts, Soc. Sci. and Humanities	(5) Share Busi- ness	(6) Share Eng., Math and Sci.
In-State Public Indicator	-12.46*** (0.47)	0.386*** (0.11)	-0.418 (1.76)	0.0151* (0.01)	-0.00163 (0.00)	0.00411 (0.01)
Mean Number of Competitors	0.0483*** (0.01)	-0.00856*** (0.00)	-0.0689*** (0.02)	0.000208* (0.00)	8.83e-06 (0.00)	9.55e-05 (0.00)
Number of Graduate Programs	0.00647 (0.01)	-0.00102 (0.00)	0.395*** (0.04)	-0.000456** (0.00)	7.29e-05 (0.00)	-2.09e-06 (0.00)
Grad Share Arts, Soc. Sci. and Humanities	2.373* (1.27)	0.634* (0.36)	-6.574* (3.71)	0.168*** (0.03)	-0.0349** (0.02)	0.0190 (0.02)
Grad Share Business and Communications	3.463** (1.42)	0.824** (0.40)	-8.282 (7.38)	-0.0544 (0.04)	0.174*** (0.05)	0.0347 (0.04)
Grad Share Eng., Math, and Sci.	-0.0532 (1.52)	3.021*** (0.45)	-20.24*** (5.94)	-0.282*** (0.06)	-0.0501** (0.02)	0.494*** (0.06)
Observations	3,324	3,324	3,324	3,324	3,324	3,324
SW F-Stat (1, 893)	128.84	32.29	127.96	82.71	65.55	58.26

NOTE: Standard errors are clustered at the university level. Exogenous university characteristics (the “Included Instruments”) are not shown. They are: room and board charges, private institution indicator, distance and distance squared, whether or not the university offers a graduate program, the NCES Locale Codes, Carnegie Size and Setting classifications, Barron’s ranks and whether the state has mandatory college admission testing.

### 9.2.3 Results

In Table 9.2 I display the results from the 2SLS estimation of equation 9.3 (column 1) and a corresponding equation for the enrollment share (column 2). The results are very similar across the two equations, except for the constant and the mandatory college admission testing indicator. In the description I will focus on the application share equation, and then briefly discuss the difference between the coefficient on universal testing in the two regressions. The first seven rows show the coefficients on the endogenous variables in the model. The coefficient on average net tuition is 0.144, which means that a \$1,000 increase in net tuition will decrease the ratio of the application share of  $j$  to the share applying to no college by 14.4 percent. A 1-point increase in the 25th percentile ACT score has approximately the same effect on applications as a \$2,292 increase in net tuition.

Both the number and type of majors affect applications. Adding a major while keeping the distribution across types the same has the same effect on applications as a \$99 decrease in net tuition. The type of major is measure in proportions relative to Health, Education, Criminal Justice, and Other, so a 1 percentage point increase in majors in Arts, Social Science, and Humanities obtained by reducing the proportion of Education majors by 1 percentage point is equivalent to a \$250 decrease in net tuition. The corresponding numbers for Business and Engineering, Math and Science categories are \$420 and \$411 dollars, respectively.

Other explanatory variables are included, such as room and board charges, an indicator for private control, distance and distance squared, whether the university has a graduate program, and the rate at which students complete the graduate program within 150% of the normal time-to-degree. All of these have intuitive signs. Controls

for NCES locale codes (loosely, whether the school is in an urban, suburban or rural area) and Carnegie Classifications for the size and setting of the institution are also included.

Finally, an indicator for whether the state has mandatory college admission testing is included.<sup>2</sup> Mandatory testing is associated with substantial increases in score-report sending—each university would see changes in score reports received equivalent to those that would be observed after a \$4,000 decrease in net tuition. However, it is not associated with any statistically significant effect on enrollment. This may occur because most of the new score reports are not associated with any applications, or because the new applications are from students who are not qualified for admission, or because universities respond to increased applications by increasing admission thresholds. Regardless, it is clear that universal admission testing substantially affects score report sending, while it is likely not associated with an increase in utility of attending each institution. Thus, in the full model, universal admission testing policies are assumed to affect application cost but not enrollment utility.

While this model shows that prices, selectivity and majors affect applications and enrollment, the model relied on some assumptions. The model of applications assumed that applications arise from an independent discrete choice where each student picked his most preferred option, but in the “real world”, students often apply to more than one university because they are uncertain about admission outcomes. Observed applications are not necessarily first choices but may represent a second or third choices (or even lower down the list). Enrollment, on the other hand, does reflect a single discrete choice, but students must enroll only at institutions to which

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<sup>2</sup>I used the list of states with mandatory testing policies by Gewertz (2018) confirming via internet research.

they apply and are admitted. The fact that the enrollment and application utility estimates differ very little reflects the strong correlation between applications and enrollment.

If students actually had to choose their most preferred option, we would likely observe a greater spread between the applicant (and enrollment) shares of the most- and least-preferred universities. For example, assume that there are two universities (1 and 2), and assume all students prefer university 1 to university 2, but prefer either university to attending no university. Assume also that there is some uncertainty in admissions. Then if applications are costless, all students will apply to both universities. If students were instead forced to choose between university 1 and 2 (e.g. by a high application cost), then all students would choose university 1 (assuming that the admissions selectivity doesn't change enough in equilibrium to alter students' rankings of the universities). In the first case, both universities have a 100% applicant share, and in the second case, university 1 has a 100% applicant share while university 2 has a 0% applicant share. Enrollment shares will change corresponding to equilibrium adjustments in admissions.

This example highlights the fact that differences in utility may not be captured correctly by a model that fails to account for the multiple-discrete choice nature of the application decision. While this is a concern in terms of interpreting the point estimates, the simple logit model does provide evidence that prices, majors offered and admission selectivity all affect applications and enrollment. Modeling the application, admission, and enrollment stages jointly gives even more—we learn separately about the application cost, admission uncertainty, and enrollment parameters, and we are able to analyze all three outcomes separately. Joining this college choice model with a supply-side model informs us about the university's preferences and likely policy

responses. These advantages come at a cost, both in terms of the assumptions imposed in the structural framework and in terms of computation. The benefits and costs are illuminated in the description of full model, identification and estimation strategy in Sections 4, 5, and 6.

Table 9.2: 2SLS Estimation of College Choice Logit (Equation 9.3)

	(1)		(2)	
	Ln(Application Share Ratio)		Ln(Enrollment Share Ratio)	
	coef.	se	coef.	se
Average Net Tuition	-0.144***	(0.0103)	-0.171***	(0.0103)
25th Percentile ACT	-0.330**	(0.138)	-0.347**	(0.143)
Number of Majors	0.0143***	(0.00492)	0.0148***	(0.00535)
Share Arts, Soc. Sci. and Humanities	3.600**	(1.655)	3.576**	(1.757)
Share Business	6.088***	(1.992)	6.453***	(2.109)
Share Eng., Math, and Sci.	5.914***	(1.797)	4.684**	(1.861)
Room and Board	-0.0262	(0.0206)	-0.0252	(0.0223)
Private Institution	-0.596***	(0.198)	-0.643***	(0.190)
Distance (1,000s mi.)	-1.808***	(0.251)	-1.957***	(0.266)
Distance Sq.	0.576***	(0.0910)	0.586***	(0.0976)
Any Graduate Program	0.363**	(0.146)	0.247	(0.165)
Completion Rt 150% Normal Time	7.458***	(1.962)	7.819***	(2.036)
Mandatory Testing	0.582***	(0.0581)	0.0197	(0.0482)
Constant	-1.579	(2.270)	-3.663	(2.405)
Observations	3,324		3,324	
R-squared	0.224		0.410	

NOTE: Standard errors are clustered at the university level. NCES Locale Codes, Carnegie Size and Setting classifications, and Barron's ranks are included but not shown.

## 9.3 Technical Notes

In the demand estimation, analytic derivatives of the GMM objective function with respect to the application cost parameters are used to supply the solvers with the gradient. In addition, certain derivatives are required for calculation of standard errors. This Appendix shows the derivation of the required expressions.

### 9.3.1 Derivatives of Applicant Shares

In estimation, the applicant shares are computed by summing over simulated  $i$ :

$$a_j = \sum_i \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \mathbb{P}(\text{Apply}_{\mathbf{Y}} | s_i, \Upsilon_i),$$

where:

$$\begin{aligned} \mathbb{P}(\text{Apply}_{\mathbf{Y}} | s_i, \Upsilon_i) &= a_{i\mathbf{Y}} = \\ &= \frac{e^{\sum_{\mathbf{D} \subseteq \mathbf{Y}} (\mathcal{P}(\mathbf{D} | s_i, \mathbf{Y}) \ln(1 + \sum_{j \text{ s.t. } D_j=1} e^{\nu_j})) - c(\mathbf{Y})}}}{\sum_{\mathbf{Y} \in \Upsilon_i} e^{\sum_{\mathbf{D} \subseteq \mathbf{Y}} (\mathcal{P}(\mathbf{D} | s_i, \mathbf{Y}) \ln(1 + \sum_{j \text{ s.t. } D_j=1} e^{\nu_j})) - c(\mathbf{Y})}}}. \end{aligned}$$

The value of an application portfolio is as defined in Section 4.3, equation 4.6:

$$V(\mathbf{Y} | s_i) = \sum_{\mathbf{D} \subseteq \mathbf{Y}} (\mathcal{P}(\mathbf{D} | s_i, \mathbf{Y}) v(\mathbf{D})) - c(\mathbf{Y}) + \epsilon_{i\mathbf{Y}}, \quad (9.5)$$

Let  $\nu_j$  represent the mean utility of university  $j$ , as defined in Subsection 4.1, and let  $\theta_1$  represent the parameters of the application cost. As in Nevo (2000), I find  $\frac{\partial \nu}{\partial \theta_1}$

using the Implicit Function Theorem:

$$\frac{\partial \boldsymbol{\nu}}{\partial \theta_1} = - \begin{bmatrix} \frac{\partial a_1}{\partial \nu_1} & \cdots & \frac{\partial a_1}{\partial \nu_J} \\ \vdots & \ddots & \vdots \\ \frac{\partial a_J}{\partial \nu_1} & \cdots & \frac{\partial a_J}{\partial \nu_J} \end{bmatrix}^{-1} \begin{bmatrix} \frac{\partial a_1}{\partial \theta_{11}} & \cdots & \frac{\partial a_1}{\partial \theta_{1H}} \\ \vdots & \ddots & \vdots \\ \frac{\partial a_J}{\partial \theta_{11}} & \cdots & \frac{\partial a_J}{\partial \theta_{1H}} \end{bmatrix}$$

The derivatives of the applicant shares with respect to the own-university mean values are:

$$\begin{aligned} \frac{\partial a_j}{\partial \nu_j} &= \frac{1}{ni} \sum_i \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \frac{\partial a_{i\mathbf{Y}}}{\partial \nu_j} \\ &= \frac{1}{ni} \sum_i \left[ \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \left[ \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_j} a_{i\mathbf{Y}} - a_{i\mathbf{Y}} \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_j} a_{i\mathbf{Y}} \right] \right] \\ &= \frac{1}{ni} \sum_i \left[ \left( 1 - \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} a_{i\mathbf{Y}} \right) \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_j} a_{i\mathbf{Y}} \right] \\ &= \frac{1}{ni} \sum_i \left[ \left( 1 - \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} a_{i\mathbf{Y}} \right) \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \left( \sum_{\mathbf{D} \in \mathbf{Y} \ni D_j=1} P(\mathbf{D}|s_i, \mathbf{Y}) \frac{e^{\nu_j}}{1 + \sum_{g \in D_g=1} e^{\nu_g}} \right) a_{i\mathbf{Y}} \right] \end{aligned}$$

And the derivatives of  $j$ 's applicant share with respect to other universities' mean values are:

$$\begin{aligned}
\frac{\partial a_j}{\partial \nu_g} &= \frac{1}{ni} \sum_i \left[ \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1, Y_g=0} \frac{\partial a_{i\mathbf{Y}}}{\partial \nu_g} + \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1, Y_g=1} \frac{\partial a_{i\mathbf{Y}}}{\partial \nu_g} \right] \\
&= \frac{1}{ni} \sum_i \left[ - \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1, Y_g=0} a_{i\mathbf{Y}} \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_g=1} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_g} a_{i\mathbf{Y}} \right. \\
&\quad \left. + \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1, Y_g=1} \left[ \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_g} a_{i\mathbf{Y}} - a_{i\mathbf{Y}} \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_g=1} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_g} a_{i\mathbf{Y}} \right] \right] \\
&= \frac{1}{ni} \sum_i \left[ \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1, Y_g=1} \left[ \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_g} a_{i\mathbf{Y}} \right] - \left[ \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} a_{i\mathbf{Y}} \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_g=1} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \nu_g} a_{i\mathbf{Y}} \right] \right]
\end{aligned}$$

Next I find the derivative of the applicant share with respect to the nonlinear parameters  $\theta_1$ :

$$\begin{aligned}
\frac{\partial a_j}{\partial \theta_1} &= \frac{1}{ni} \sum_i \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \frac{\partial a_{i\mathbf{Y}}}{\partial \theta_1} \\
&= \frac{1}{ni} \sum_i \sum_{\mathbf{Y} \in \Upsilon_i \ni Y_j=1} \left[ \frac{\partial V(\mathbf{Y}|s_i)}{\partial \theta_1} a_{i\mathbf{Y}} - a_{i\mathbf{Y}} \sum_{\mathbf{Y} \in \Upsilon_i} \frac{\partial V(\mathbf{Y}|s_i)}{\partial \theta_1} a_{i\mathbf{Y}} \right]
\end{aligned}$$

This is the last derivative required to compute  $\frac{\partial \nu}{\partial \theta_1}$  using the Implicit Function Theorem. This derivative is used in calculation of the standard errors for the application cost parameters, and to supply the gradient to the solver in the GMM estimation routine. In addition, the derivatives  $\frac{\partial a_j}{\partial \nu_j}$  and  $\frac{\partial a_j}{\partial \nu_g} \forall g \neq j$  are used to create the gradient in the Newton's method iterations discussed in Subsection 6.3.



### 9.3.2 Derivatives of Enrollment

Derivatives of the enrollment share equation are also necessary to supply to the gradient of the solver, and to compute standard errors. I derive these here. In estimation, the total probability of enrollment in a state is simulated across individuals  $i$ , so the within-state enrollment share is given by:

$$e_j = \frac{1}{ni} \sum_i \mathbb{P}(Enroll_{ij}|s_i, \Upsilon_i),$$

where

$$\mathbb{P}(Enroll_{ij}|s_i, \Upsilon_i) = \sum_{\mathbf{Y} \in \Upsilon \ni Y_j=1} \mathbb{P}(Apply_{\mathbf{Y}}|s_i, \Upsilon_i) \sum_{\mathbf{D} \in \mathbf{Y}} \mathcal{P}(\mathbf{D}|s_i, \mathbf{Y}) \mathbb{P}(Enroll_{ij}|\mathbf{D}).$$

The derivatives of the enrollment share wrt the application cost parameters  $\theta_1$  are:

$$\frac{\partial e_j}{\partial \omega} = \frac{1}{ni} \sum_{i \in l} \sum_{\mathbf{Y} \in \Upsilon \ni Y_j=1} \frac{\partial \mathbb{P}(Apply_{\mathbf{Y}}|s_i, \Upsilon_i)}{\partial \theta_1} \sum_{\mathbf{D} \in \mathbf{Y}} \mathcal{P}(\mathbf{D}|s_i, \mathbf{Y}) \mathbb{P}(Enroll_{ij}|\mathbf{D})$$

## 9.4 Solutions to the Public University FOCs

The pricing and selectivity FOCs can be solved together for  $\alpha_6^{pub} + \omega_{0j}^{is}$ :

$$\begin{aligned} & \frac{\left( \frac{\partial q_j^{is}}{\partial \underline{s}_j} + \frac{\partial q_j^{os}}{\partial \underline{s}_j} \right) \left( \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{os}} q_j^{is} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} q_j^{os} \right) - \left[ \frac{\partial q_j^{os}}{p_j^{os}} \frac{\partial \tilde{s}(\underline{s}_j)}{\partial \underline{s}_j} q_j^{is} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial \underline{s}_j} \frac{\partial q_j^{is}}{p_j^{is}} q_j^{os} \right]}{\left( \left[ \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} \frac{\partial q_j^{is}}{\partial \underline{s}_j} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial \underline{s}_j} \frac{\partial q_j^{is}}{p_j^{is}} \right] \frac{\partial q_j^{os}}{p_j^{os}} + \frac{\partial q_j^{os}}{\partial \underline{s}_j} \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{os}} \frac{\partial q_j^{is}}{p_j^{is}} \right)} + p_j^{is} - p_j^{os} \\ &= \alpha_6^{pub} + \omega_{0j}^{is} \end{aligned}$$

Derive an expression for the out-of-state per-student cost,  $c_j^{os}(\mathbf{M}_j)$ , from the two pricing conditions:

$$\begin{aligned} & \frac{\frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{os}} \frac{\partial q_j^{is}}{p_j^{is}} (p_j^{is} - p_j^{os} - \alpha_5^{pub} - \omega_5) - \left( \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} q_j^{os} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{os}} q_j^{is} \right)}{\left[ \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} \frac{\partial q_j^{os}}{p_j^{os}} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{os}} \frac{\partial q_j^{is}}{p_j^{is}} \right]} \\ &= \left( (p_j^{os} + t_j) - (c_j^{os}(\mathbf{M}_j) + q_j(\alpha_2^{pub} + \alpha_3^{pub} \mathbf{M}_j)) \right) \end{aligned}$$

Majors FOCs:

$$\begin{aligned} & \frac{1}{\frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} q_j} \left( \left[ \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} \frac{\partial q_j^{is}}{M_{jk}} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial M_{jk}} \frac{\partial q_j^{is}}{p_j^{is}} + \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} \frac{\partial q_j^{os}}{M_{jk}} \right] ((p_j^{os} + t_j) - (c_j^{os}(\mathbf{M}_j) + q_j(\alpha_2^{pub} + \alpha_3^{pub} \mathbf{M}_j))) \right. \\ & \quad \left. - \left[ \frac{\partial \tilde{s}(\underline{s}_j)}{\partial p_j^{is}} \frac{\partial q_j^{is}}{M_{jk}} - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial M_{jk}} \frac{\partial q_j^{is}}{p_j^{is}} \right] (p_j^{os} - p_j^{is} + \alpha_6^{pub} + \omega_{0j}^{is}) - \frac{\partial \tilde{s}(\underline{s}_j)}{\partial M_{jk}} q_j^{is} \right) \\ &= \alpha_{1k}^{pub} + \alpha_{3k}^{pub} q_j + 2\alpha_{4k}^{pub} M_{jk} + \omega_{jk} \end{aligned}$$

Selectivity FOC:

$$\frac{\frac{\frac{\partial \mathcal{R}(p_j^{is}, p_j^{os})}{\partial \underline{\mathbf{S}}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial \underline{\mathbf{S}}_j}}{\mathcal{R}(p_j^{is}, p_j^{os}) - \mathcal{C}(\mathbf{M}_j)}}}{\left( \frac{\frac{\frac{\partial \mathcal{R}(p_j^{is}, p_j^{os})}{\partial \underline{\mathbf{S}}_j} - \frac{\partial \mathcal{C}(\mathbf{M}_j)}{\partial \underline{\mathbf{S}}_j}}{\mathcal{R}(p_j^{is}, p_j^{os}) - \mathcal{C}(\mathbf{M}_j)}} - \frac{\frac{\partial \bar{s}(\underline{\mathbf{S}}_j)}{\partial \underline{\mathbf{S}}_j}}{\bar{s}(\underline{\mathbf{S}}_j)} \right)} = \lambda_0^{pub} + \epsilon_j^s$$

## 9.5 Tables

Table 1: CIP Major Examples

Major Category	CIP Code and Description
Arts, Social Sci. and Humanities	54.0101 History, General.
Arts, Social Sci. and Humanities	54.0102 American History (United States).
Arts, Social Sci. and Humanities	54.0103 European History.
Arts, Social Sci. and Humanities	54.0104 History and Philosophy of Science and Technology.
Arts, Social Sci. and Humanities	54.0105 Public/Applied History.
Arts, Social Sci. and Humanities	54.0106 Asian History.
Arts, Social Sci. and Humanities	54.0107 Canadian History.
Arts, Social Sci. and Humanities	54.0199 History, Other.

NOTE: The table provides examples of majors that can be offered within social sciences and history, to demonstrate the level of detail in the major classification. This is not an exhaustive list of majors.

Table 2: Majors

Category	# Majors	Code	CIP Title
Arts, Soc. Sci. and Humanities	373	4	ARCHITECTURE AND RELATED SERVICES.
		5	AREA, ETHNIC, CULTURAL, GENDER, AND GROUP STUDIES.
		16	FOREIGN LANGUAGES, LITERATURES, AND LINGUISTICS.
		22	LEGAL PROFESSIONS AND STUDIES.
		23	ENGLISH LANGUAGE AND LITERATURE/LETTERS.
		24	LIBERAL ARTS AND SCIENCES, GENERAL STUDIES AND HUMANITIES.
		30	MULTI/INTERDISCIPLINARY STUDIES.
		38	PHILOSOPHY AND RELIGIOUS STUDIES.
		39	THEOLOGY AND RELIGIOUS VOCATIONS.
		42	PSYCHOLOGY.
		45	SOCIAL SCIENCES.
		50	VISUAL AND PERFORMING ARTS.
		54	HISTORY.
Business and Comm. Eng., Math, and Sci.	132	9	COMMUNICATION, JOURNALISM, AND RELATED PROGRAMS.
		10	COMMUNICATIONS TECHNOLOGIES/TECHNICIANS AND SUPPORT SERVICES.
	305	52	BUSINESS, MANAGEMENT, MARKETING, AND RELATED SUPPORT SERVICES.
		11	COMPUTER AND INFORMATION SCIENCES AND SUPPORT SERVICES.
		14	ENGINEERING.
		15	ENGINEERING TECHNOLOGIES AND ENGINEERING-RELATED FIELDS.
		26	BIOLOGICAL AND BIOMEDICAL SCIENCES.
		27	MATHEMATICS AND STATISTICS.
		40	PHYSICAL SCIENCES.
		41	SCIENCE TECHNOLOGIES/TECHNICIANS.
Other	723	1	AGRICULTURE, AGRICULTURE OPERATIONS, AND RELATED SCIENCES.
		3	NATURAL RESOURCES AND CONSERVATION.
		12	PERSONAL AND CULINARY SERVICES.
		13	EDUCATION.
		19	FAMILY AND CONSUMER SCIENCES/HUMAN SCIENCES.
		21	TECHNOLOGY EDUCATION/INDUSTRIAL ARTS.
		25	LIBRARY SCIENCE.
		28	MILITARY SCIENCE, LEADERSHIP AND OPERATIONAL ART.
		29	MILITARY TECHNOLOGIES AND APPLIED SCIENCES.
		31	PARKS, RECREATION, LEISURE, AND FITNESS STUDIES.
		33	CITIZENSHIP ACTIVITIES.
		34	HEALTH-RELATED KNOWLEDGE AND SKILLS.
		36	LEISURE AND RECREATIONAL ACTIVITIES.
		43	HOMELAND SECURITY, LAW ENFORCEMENT, FIREFIGHTING AND RELATED PROTECTIVE SERVICES.
		44	PUBLIC ADMINISTRATION AND SOCIAL SERVICE PROFESSIONS.
		46	CONSTRUCTION TRADES.
		47	MECHANIC AND REPAIR TECHNOLOGIES/TECHNICIANS.
		48	PRECISION PRODUCTION.
		49	TRANSPORTATION AND MATERIALS MOVING.
		51	HEALTH PROFESSIONS AND RELATED PROGRAMS.

NOTE: The table provides the total number of majors (six-digit CIP codes) in each of the four categories that I use in my analysis. I also list the two-digit CIP codes that were grouped to create each category.

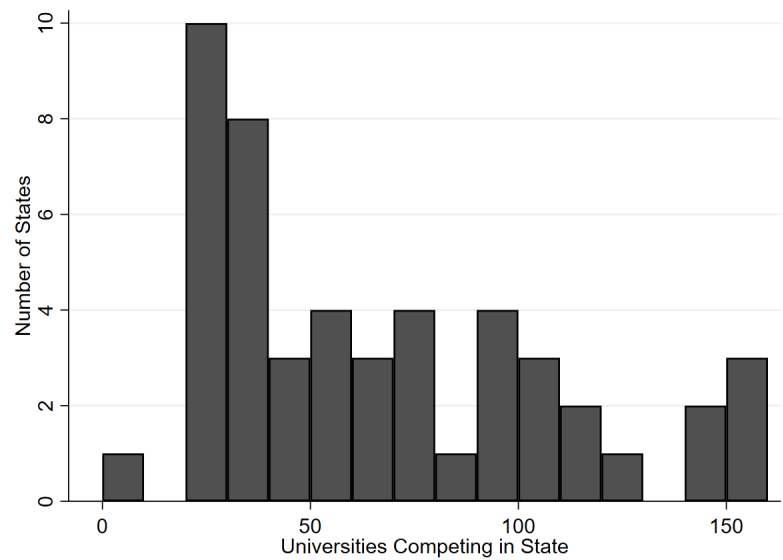
Table 3: Summary of Application and Enrollment Data

	Application	Enrollment
	Penetration	Share
Mean	0.02171	0.00440
Min	0.00150	0.00005
10th Percentile	0.00212	0.00025
25th Percentile	0.00372	0.00041
50th Percentile	0.00811	0.00091
75th Percentile	0.01847	0.00278
90th Percentile	0.04726	0.00943
Max	0.42951	0.15634

NOTE: This table shows the mean, min, max and percentiles of the enrollment and application variables used to estimate the college choice model. The application penetration for an institution is the proportion of high school graduates from a state market who sent a score report to the institution. The enrollment share is the proportion of high school graduates who enrolled at the institution.

## 9.6 Figures

Figure 1: Number of Universities Competing in Each State Market



NOTE: This graph shows the distribution of the number of universities competing in each market.

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