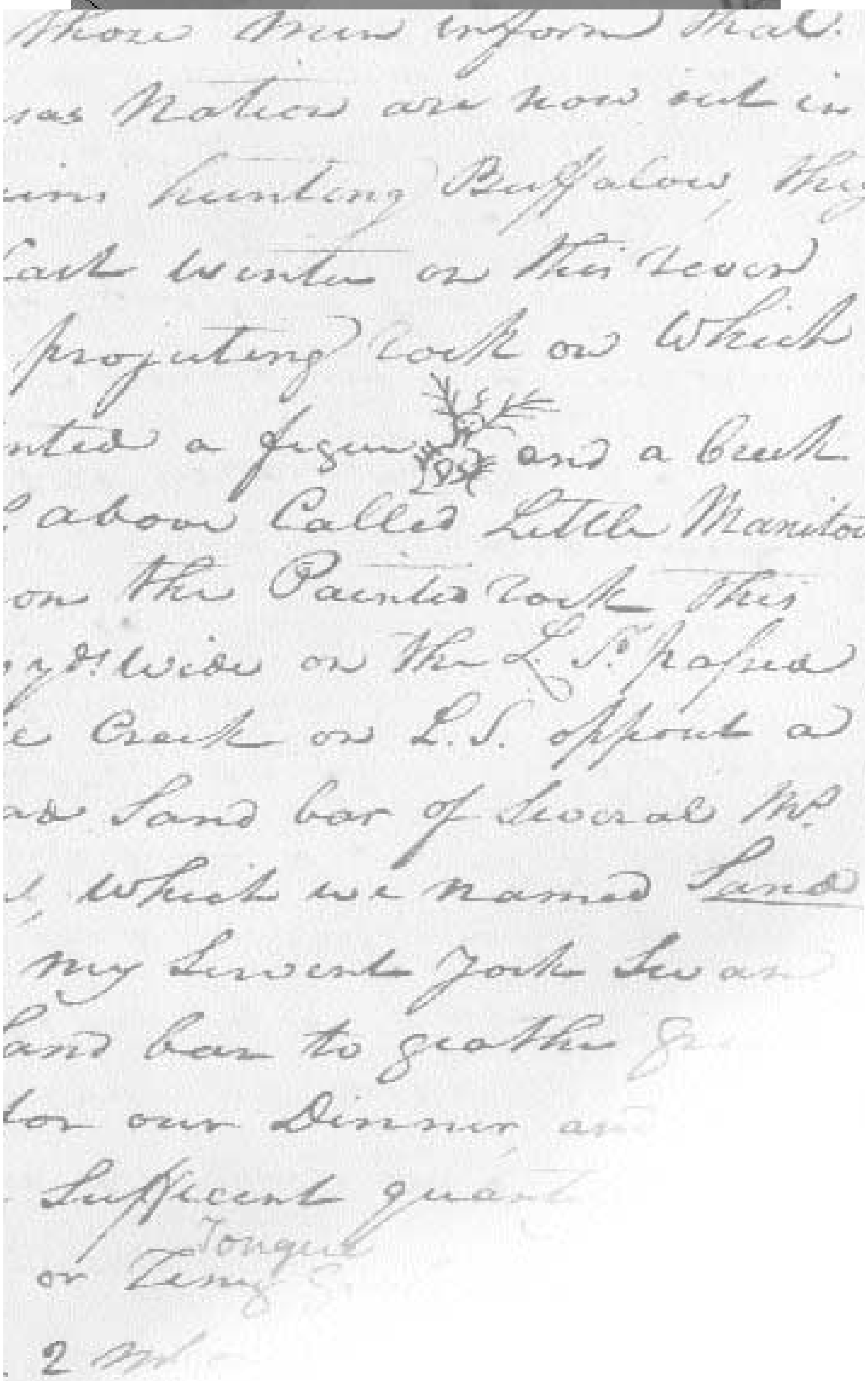
Winner-Take-All... Even in Higher Education



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Hierarchical rankings in higher education have become far more important than ever, because the economic reward for elite educational credentials has jumped sharply in recent decades. Underlying these changes is the spread of *winner-take-all* markets, in which small differences in performance (or even small differences in the credentials used to predict performance) translate into extremely large differences in reward. Robert Frank, Goldwin Smith Professor of Economics, Ethics, and Public Policy at Cornell University, describes the evolution and the effects of the winner-take-all trend in higher education.

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The Higher Education Market

The market for higher education is fundamentally different from the typical markets portrayed in economics textbooks. When excess demand arises in the market for an ordinary good or service, it is almost always fleeting: producers rush to fill the void, or prices rise so much that the market quickly clears. Not so in the upper reaches of the academic market. Despite the persistence of excess demand, elite colleges and universities continue to turn away thousands of well qualified applicants, while charging those they admit only about one-third of what it costs to serve them.

Why don’t elite universities simply raise their prices? Because a university’s status depends heavily on the average intellectual ability of its students, elite universities need top students every bit as much as top students feel the need to attend elite institutions. This co-dependence creates multiple positive-feedback loops that amplify the rewards for a university that succeeds in its efforts to recruit top students and faculty. The result is a quintessential winner-take-all market, in which success breeds success and failure breeds failure.

The Positional Arms Race

Participants in virtually all winner-take-all markets face strong incentives to invest in performance enhancement, thereby to increase their chances of coming out ahead. As in the classic military arms race, however, many such investments prove mutually offsetting in the end. When each nation spends more on bombs, the balance of power is no different than if none had spent more. Yet that fact alone provides no escape for individual participants. Countries may find it burdensome to spend a lot on bombs, but the alternative—to be less well-armed than their rivals—is even worse.

In light of the growing importance of rank in the education marketplace, universities face increasing pressure to bid for the various resources that facilitate the quest for high rank. These pressures have spawned a *positional arms race* that already has proved extremely costly, and promises to become more so.

Colleges and universities up and down the academic totem pole are spending far more than ever on brochures, videos, mailings, travel by admissions officials, and other efforts to woo top students. Competition for distinguished, highly visible faculty—another essential ingredient of elite educational status—also has intensified, so that today star faculty command ever higher salaries and require ever more elaborate and costly support. Further, pressure to upgrade campus amenities abounds, with rising student expectations for nicer dormitories, better food, fancier athletics complexes, state-of-the-art classrooms, and comprehensive career counseling and job placement services.

Yet when all schools increase such expenditures, their actions largely cancel one another out. The additional spending inflates costs, but in the end has little impact on the ultimate distribution of students.

Implications for Access to Higher Education

An arms race is expensive. Inevitably, some portion of the institutions’ increased costs are passed on to students in the form of higher tuition, creating new financial hurdles and adversely affecting access to higher education for middle and low-income students.

Competition also has wrought sweeping changes in financial aid decisions. In the past, need-based aid prevailed at elite institutions, creating an open climate of access for students of all income levels. Today, as colleges and universities compete for top students, financial aid is routinely awarded to applicants whose families could readily afford to pay full tuition—and little wonder, since these families often are in the position of weighing offers of aid from several schools vying to enroll their child. As more merit aid is used to compete for students with marginally better grades and test scores, funds available for need-based financial aid are diminished. Middle and low-income students are confronted not only by higher

tuition, but also by lower financial aid. This combination at best steers them away from top-ranked institutions and, at worst, discourages their pursuit of higher education altogether.

Positional Arms Control Agreements

The competitive dynamics that govern the battle for elite educational status virtually guarantee a measure of social waste. Each dollar spent on recruiting by a university delivers the benefit of helping it to lure good students away from other schools; on the social scale, however, these benefits sum to zero, because one school's gain is offset by another's loss. From a social perspective, then, it would be better if all schools spent less. Yet no school dares to cut its own expenditures unilaterally.

Under these circumstances, it is often possible to generate socially preferred outcomes through positional arms control agreements, pacts in which contestants pledge mutual restraint. Such agreements are particularly important in winner-take-all markets, in which reward depends heavily on rank, and in which behavior that looks attractive to each individual often looks profoundly unattractive from the perspective of the group. Collusive agreements to restrain these behaviors can create gains for everyone. They should not be summarily judged as wrong based on the uncritical belief that unlimited competition necessarily leads to the greatest good for all.

The challenge is to distinguish between agreements that compromise the positive forces of competition and those that limit its harmful effects. The collective agreement among several elite institutions to target their limited financial aid to students with the greatest need was attacked by the U.S. Justice Department for being a restraint on open competition. It was precisely that, but that does not mean it was a bad thing. Once we appreciate the logic of the financial incentives that confront participants in winner-take-all markets, it becomes clear that collective agreements to restrain competition can often create gains for everyone. Such agreements should be scrutinized not according to outmoded textbook models of the widget market, but according to the practical test of whether they limit harmful effects of competition without compromising its many benign effects.

Conclusion

No college or university, acting alone, can escape the powerful logic of the positional arms race. Yet there remain compelling ethical reasons both for limiting escalation in the cost of acquiring higher education, and for basing financial aid more heavily on need than on merit. Indeed, the growth in income and wealth inequality caused by spreading winner-take-all markets makes the case for cost containment and need-based aid more compelling than ever.

But such goals can be met only through collective action. Positional arms control agreements may be the only practical way to keep higher education within reach for the average American family. To resist these agreements on the grounds that they are anti-competitive would make sense if the market for higher education were just like the market for an ordinary private good or service, but it is not. To move forward effectively, institutions must be permitted to come together to defuse higher education's positional arms race.

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