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POINT OF VIEW

Colleges and Student Aid: Collusion or Competition?

By PETER CARSTENSEN

The presidents of 28 private colleges recently endorsed a set of common standards for measuring a family's ability to pay for college -- such as how to calculate the value of home equity or the financial need of a student with divorced parents. The presidents of the participating colleges -- which all offer need-based aid -- are known as the "568 Presidents' Working Group," named after the section number of the antitrust exemption that permits them to collaborate on needs analysis but not on the specific aid awards that they offer individual students.

In announcing the proposed guidelines, Hunter R. Rawlings III, the president of Cornell University and the group's chairman, said that he hoped the new standards would encourage other private institutions to adopt a similar "consensus approach." The ostensible aim: to curb colleges' growing use of scholarships or low-interest loans to compete for the students they most prize -- and thus reallocate more aid for the "neediest" applicants.

Yet as lofty as that goal sounds, it's hard not to question the presidents' motives. On the face of it, their efforts appear to be well-meaning, but how their recommendations play out will certainly bear watching. The 568 group's "consensus" strategy invites high-price, brand-name private institutions to eliminate price competition by private, collective action. And who would benefit then? The students? Or the colleges themselves, operating much like a cartel?

Past history creates cause for concern. In the early 1990's, the U.S. Department of Justice charged some of the same colleges, including Cornell, with violating the Sherman Antitrust Act by conspiring to restrain price competition through the financial aid that they provided. Those colleges, known collectively as the Overlap Group, entered into a consent decree, promising not to collude on the amount of aid that they offered specific students. Congress limited the scope of the decree by the 568 exemption, but that exemption will expire in September of this year. (The U.S. House of Representatives approved its renewal in April; the Senate has yet to schedule any action.)

Interestingly, that consent decree should also expire soon, 10 years from when it was filed in 1991. Even without the exemption, some competitor collaboration already is lawful, and the expiration of the decree would further reduce the risk of government intervention -- especially if the collusion were less overt than in the Overlap case. Antitrust law would still apply, but any future challenge would face significant legal issues because the Supreme Court recently indicated that protecting consumer interests may justify cartel-like agreements.

In *The California Dental Association v. Federal Trade Commission* (1999) the court upheld the right

of California dentists to defend their agreement not to engage in various kinds of discount advertising -- on grounds that such ads could deceive customers. The opinion was ambiguous as to when such a defense comes into play and what factors are relevant. Nevertheless, lawyers for the presidents' group can take some comfort. If Congress renews 568, that exemption and the California decision would make another government case against cartel-like conduct much more difficult.

As a result, the colleges may be more free to re-create some version of the Overlap Group on an expanded basis. And there is at least a prima facie case that the presidents' proposals could lead to just that.

Why? In the world of antitrust, a history of collusive behavior as well as statements like those of Rawlings suggest that present activity may be a continuation of past misconduct -- especially if an economic rationale for anticompetitive activity still exists.

And, of course, in this case, that rationale definitely remains. The plain truth is that private colleges compete for students in the same ways and for the same reasons that producers of other goods and services compete for customers. Selling a college education is a business, and competition for the most coveted students grows keener everyday.

Consumer perceptions of the quality and value of an institution are important, but so is price. Any applicant or parent makes a trade-off between the perceived advantages of a high-prestige, brand-name college and the institution's price. Low-interest loans, scholarships, and grants are basically discounts off that price. Thus, the strategy behind colleges' financial aid is no different from the rebates and low-cost financing that automobile manufacturers offer to make their products more attractive.

Indeed, when I first read the Rawlings statement, I thought of the famous cartel case involving Archer Daniels Midland Company and the product lysine -- an amino acid used to stimulate an animal's growth. The manufacturers agreed on price, eliminated discounts, and allocated sales volumes among themselves. In *United States of America v. Michael D. Andreas and Terrance S. Wilson* (2000), the F.B.I., through an undercover sting operation, made videotapes of the conspirators' meetings that were introduced at the trial. In one segment, an A.D.M. executive (who was later convicted of price-fixing and sentenced to prison) said to his competitors: "We are gonna get manipulated by these God damn buyers, ... they can be smarter than us if we let them be smarter. ... I wanna be closer to you than I am to any customer."

If one substitutes "applicants" or "parents" for buyers, the parallel in thinking is manifest: Private, high-price, high-prestige colleges want to avoid price competition because that is in their best interests -- not those of the students and their families. The colleges may protest otherwise, but when a group of businesses proposes to limit or eliminate price competition, they often claim that they are doing so in the best interest of consumers and the public. Such institutions will still compete on such features as location, faculty, special programs, and amenities. But by agreeing on the amount of any discount, competing colleges are able to collect higher tuitions on average and thus receive more revenue.

Despite the opportunities for the 568 group to engage in cartel-like behavior, several factors may mitigate against it. For one, a cartel cannot function effectively unless its membership involves all or most key competitors. The 568 group includes, for example, many Northeastern institutions but not Brown University or Dartmouth College. Further, although it is difficult to know how much all 28 institutions compete among themselves without aggregate data on their mutual applicants, their

differences in institutional type and location may also preclude cartel-like behavior. If the 568 institutions compete with nonparticipants for a substantial share of students, they could lose many desired customers to price competition.

The potential for price-fixing will become greater if more institutions, especially those most directly competitive with the 568 group, adopt the "consensus approach." But if those competitive colleges continue to use alternative methods of determining their discounts, students and their families could continue to benefit from competition, even if the 568 group adhered to their standards. Applicants, aware of the alternative discount strategies, could make informed choices based on the trade-off between their individual financial need and attributes -- such as academic merit, athletic ability, or their relationship to past graduates -- that competing institutions would value in awarding aid.

Meanwhile, the new guidelines endorsed by the presidents reflect just how complicated and idiosyncratic financial-aid analysis and awards can be. The guidelines raise questions like the following, but don't give clear direction on how to handle them: How much weight should one give to the potential contribution of the noncustodial spouse? How do you value day-trading in securities? How do you identify the contribution that can be expected from a small business owned by the parents of an applicant? These are tough questions -- with, one suspects, no right answers.

In fact, the way that individual institutions interpret and carry out the 568 group's proposals will tell us the most about their actual intent and function. The presidents' proposals emphasize that each financial-aid officer needs to use his or her professional judgment in applying the guidelines. Moreover, the guidelines attempt to create uniform standards for assessing the needs of students, but do not define the mix of types of aid -- whether grants or loans, for example -- or the total amount of aid that institutions can offer.

Nor do the guidelines call for any direct, pre-award comparison of need determination for individual students -- the activity that made the Overlap Group so obviously illegal. The 568 group plans to review summary information about the aid provided admitted students in aggregate, drawing on a cluster of Northeastern colleges in the group that are most likely to have many applicants in common. But such after-the-fact evaluation is not likely to protect against "cheating" on aid awards. Whether more elaborate evaluations would produce effective control over individual awards is hard to say.

So which will it be? Will the new standards suppress competition for students? Or will they make those colleges with a particular approach to discounting more sophisticated and effective in performing the complex task of needs assessment?

The proposed guidelines can, in fact, benefit students -- but only as long as the institutions continue to focus on developing and applying the general standards for determining need. Need-based aid requires workable criteria to define need and family resources, as well as timely and appropriate data -- for example, which tax-return items to check -- to determine the issues. Professional judgment and experience are vital to the process. In any complex business situation -- which college admissions definitely is -- sharing such expertise and experience can provide useful insights and facilitate informed decision making.

If the standards allow sufficient discretion for aid to be varied, depending on the interest of the institution in making a particular "sale," and individual institutions use that discretion, they will not significantly interfere with competition. They may even, through informed discussion and exchange of information, provide a basis to better determine the indeterminate: the need of the student.

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Section: The Chronicle Review

Page: B24

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