



## Financial Aid and College Choice

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Each year thousands of high school seniors make the important decision of where to go to college. With tuition at many schools rising faster than the rate of inflation, financing a college education is becoming increasingly challenging. (In fact, in the United States, the growth rate of college costs since 1990 has been, on average, nearly 3 percent higher than the overall inflation rate.) Offers of financial aid—a complex menu of grants, loans, and work-study—vary by school. Indeed, some students may consider a school’s academic attributes and their projected influence on the student’s lifetime earning potential as less important than the school’s financial aid package. Thus, the way students weight financial aid offers can have a substantial impact on their choice of college.

Working with counselors from 510 U.S. high schools, economists Christopher Avery and Caroline Hoxby<sup>1</sup> surveyed high-aptitude high school seniors (students likely to gain admission and merit scholarships from selective colleges) to study how students assess financial aid packages. In particular, they sought to determine how financial aid characteristics affect the probability that the student will choose a particular school, taking into account individual attributes: SAT score, GPA, legacy status, etc. Avery and Hoxby assert at the outset that there are distinguishing characteristics across financial aid packages that do not necessarily add value. Nevertheless, they find that approximately 30 percent of the students in their sample responded strongly to what are arguably trivial distinctions between financial aid packages.

The first distinguishing characteristic is whether or not a grant is called a “scholarship.” Clearly, the amount of the grant, not its name, should be what matters. (In fact, the authors note that the amount of a grant is actually negatively correlated to it being designated as a “scholarship.”) Nevertheless, Avery and Hoxby find that students are very responsive to this distinction when deciding which college to attend. Students may consider a named scholarship to be more impressive than an unnamed grant when listed on resumes or job applications—perhaps because scholarship connotes merit-based aid and grant connotes need-based aid.

The second characteristic Avery and Hoxby consider is whether or not the grant is front-loaded, meaning the student receives more aid in his or her freshman year than in later years. An example would be a grant that gives \$10,000 the first year and \$2,000 each of the subsequent three years as opposed to a grant that gives \$4,000 each of the four years. Avery and Hoxby find strong student response to front-loading. Potential reasons for students to prefer front-loading are clear: Front-loading better allows students to consider the possibility of transferring to a different school after the first year or two; it gives parents more time to save money toward the total cost of college; and it gives parents the opportunity to earn interest on their savings before spending it on college tuition. Whether these factors can explain the strong response to front-loading that Avery and Hoxby document is an arguable point, since it is hard to put a particular value on many of these considerations.

One might ask whether or not student sensitivity to these two aspects of financial assistance depends on family background, such as parental income and where their parents went to college. Avery and Hoxby present some evidence that it does. They find that a grant designated as a scholarship significantly attracts students in every income group except those whose parents have a high income or whose parents attended highly selective colleges. Interestingly, they find that student reaction to front-loading depends on neither family income nor the selectivity of their parents’ college.

When assessing the financial aid incentives that colleges offer, students and their families must determine how much value they place on the fine distinctions that exist between competing financial aid packages. The empirical evidence suggests that students respond subjectively to financial aid factors that are difficult to value quantitatively. With better awareness of how students respond to various financial aid characteristics, economists, educators, and policymakers can better understand the process of college choice. ■

<sup>1</sup>Avery, Christopher and Hoxby, Caroline. “Do and Should Financial Aid Packages Affect Students’ College Choices?” NBER Working Paper No. 9482, National Bureau of Economic Research, February 2003.