

For-Profit College Policy at the Crossroads

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The first decade of the 2000s witnessed a rapid expansion of enrollment in for-profit colleges (FPCs). Between 2000 and 2010, enrollment in the sector more than tripled, climbing to 2.4 million students (Snyder, de Brey, and Dillow 2016). Allegations of FPC misconduct ushered in a wave of federal sanctions and regulations beginning around 2010. Since then, enrollment in the for-profit sector has declined sharply, but the sector continues to enroll a substantial fraction of postsecondary students (9 percent as of 2014) (Snyder, de Brey, and Dillow 2016).

The scandal and regulation involving FPCs under the Obama administration is not new. Since the 1950s, FPCs have been in a roughly 20-year cycle of scandals, investigations, and regulations. Today, FPC policy is at a crossroads. Pulling back on recent measures that hold FPCs accountable for program quality would likely perpetuate the cycle. Reinforcing or expanding these measures could break it.

Early indicators suggest that Congress and the new administration are leaning toward pulling back on FPC accountability. They have delayed implementation of the new gainful employment (GE) rule—a measure designed to hold FPCs accountable for student outcomes—and appointed FPC executives to key roles in the US Department of Education. Still, the fate of the GE rule remains undecided, and it is not clear how the administration views the subsidization of FPCs via federal student aid programs, which are the key revenue source for many FPCs. In this memo, we review the evidence on FPC student outcomes and institutional behavior and present our recommendations for policy action at the crossroads.

We focus on a body of relatively new research that has developed alongside the expansion of the for-profit sector since 2000. One strand of research shows that FPC students have disappointing labor market, debt, and default outcomes, particularly compared with similar college students in other postsecondary sectors. Another strand focuses on the institutions themselves, where a key take-away is that programs at public and nonprofit colleges offer reasonable substitutes for FPC programs and at a lower cost (to students and in total). Correspondingly, we recommend that federal officials continue efforts to regulate FPCs. We focus our policy proposals on a useful tool in the hands of federal policymakers: access to revenue generated through federal student aid programs.

Recent History and the Current Policy Climate

Waves of intense scrutiny and regulation of FPCs have occurred at least three times in recent history before the Obama administration: in the 1950s under Truman, in the 1970s under Ford, and in the 1990s under Bush.¹ Under the Obama administration, the cycle began again with an influential 2010 US

Government Accountability Office report that uncovered fraud and abuse at several large FPCs. The scathing Harkin report—the product of a two-year investigation of FPCs by the US Senate Committee on Health, Education, Labor, and Pensions led by Senator Tom Harkin—was released shortly thereafter, and the GE rule followed. The Department of Education also restricted federal aid to several large for-profit colleges charged with using fraudulent practices to increase enrollment. By 2016, for-profit giants Corinthian and ITT Tech both closed and their accreditor’s authority was revoked, disrupting the lives of tens of thousands of students.

Today, the future of the GE regulation is in doubt, and the first sanctions under GE have already been delayed. Many analysts predict renewed growth in the for-profit sector. Stock prices of publicly held FPCs surged after the recent presidential election, and Trump’s appointments in the Department of Education have been viewed as favorable to the for-profit industry. At the same time, Purdue University recently proposed to buy Kaplan University, a major FPC chain, and other FPCs have strategically switched to nonprofit status, blurring the lines of institutional control in the postsecondary sector.

Who Attends FPCs, and What Are Their Outcomes?

Students who attend FPCs come from more disadvantaged backgrounds than students in other sectors (Deming, Goldin, and Katz 2012). An implication of their relative disadvantage is that they likely have less information about their college choices. Researchers have documented significant gaps in how well even high-achieving low-income students (in all sectors) understand financial aid and college selectivity (Hoxby and Turner 2015).

College is an “experience good,” which means that it is difficult for prospective students to judge the quality of the product without experiencing it directly or indirectly (e.g., through a parent). Given that students who attend FPCs are more likely to be the first in their family to attend college, it is unsurprising that they rely more on college staff for information than students in other sectors (Cellini and Darolia 2016). If the incentives of FPC recruiters and other staff are aligned with student incentives, this is not a concern. But given the strong incentive of FPCs to generate profits for shareholders, rather than reinvesting profits into the organization or fulfilling a social mission—as in the nonprofit and public sectors—it is not clear that this is the case. Evidence of misleading recruiting practices at FPCs raises additional concerns about improprieties in the for-profit sector (Kutz 2010).

Policymakers have an important regulatory role to play in protecting both students and taxpayers from low-quality institutions. The motivation for a regulatory role of government in this instance is not merely paternalistic. In a market with poor and asymmetric information, regulation can enhance efficiency. For regulation to be effective, it is critical that it be based on evidence of program quality. But how should college quality be judged? Although education has many benefits, we argue that labor market outcomes are the most important for assessing the value of educational investments. In a forthcoming article (Cellini and Koedel, forthcoming), we summarize research from 12 recent studies on how FPC attendance affects labor market outcomes. The studies are from numerous authors and rely on different data sources. They use various methodologies to disentangle the influence of FPC

attendance from other factors associated with the nonrandom selection of students into FPCs. A consistent pattern emerges from these studies: relative to traditional colleges, the effects of FPCs range from negative to null. Several studies also compare labor market outcomes of FPC students to outcomes of individuals who have only a high school diploma and find null or small positive effects, raising the question of whether FPC returns are large enough to offset the cost even when the alternative is to forgo college altogether.

Related to labor market outcomes are loan repayment and default outcomes. These outcomes can be viewed as summary measures that combine labor market outcomes and college prices. For-profit colleges fare poorly on measures of loan performance, which is not surprising given the evidence on labor market outcomes and the much higher cost to students of FPC attendance. In total, FPC students account for 35 percent of all loan defaults, a greatly disproportionate share.² Moreover, a substantial default-rate gap persists between FPCs and other colleges, even after conditioning on rich observable information about students and institutions (Belfield 2013; Deming, Goldin, and Katz 2012).

Consistent with the disappointing labor market and loan outcomes of FPC students, research shows that students who attend FPCs are less likely to report that their education was worth the cost and that their loans were a worthwhile investment (Deming, Goldin, and Katz 2012). These survey results suggest that students make college choices *ex ante* that they would not have made *ex post* and are in line with our framing of postsecondary education as an experience good.

Research on FPCs' Institutional Features and Behaviors

Another burgeoning area of research focuses on the institutional behavior of FPCs, their responses to policy, and student flows across sectors.

It is well known that FPC tuition and fees are much higher than those of public institutions—around \$15,000 a year compared with \$3,300 for public two-year institutions (Snyder, de Brey, and Dillow 2016). In addition to being more expensive for students, Cellini (2012) shows that the total cost of an FPC education, inclusive of both student and taxpayer costs, is also substantially higher than in the public sector. This is because the lower per student cost to taxpayers of an average FPC education is more than offset by the high prices students pay and their corresponding debt accumulation.

A key question in the institutional literature follows from these tuition differences, asking whether students who attend FPCs have other options for education and training. The for-profit sector often argues that the students they enroll have few alternatives (Guryan and Thompson 2014), in which case policies that result in closing low-quality FPCs would reduce access to higher education. Per above, it is not obvious from research that FPC access is superior to no college access at all. Moreover, new research suggests a high degree of substitutability between FPCs and public colleges. Cellini, Darolia, and Turner (2016) find that when FPCs lost access to federal student aid under the cohort default-rate regulations in the 1990s, enrollment losses in the for-profit sector were offset by enrollment gains at local public institutions, suggesting that aid loss shifts students across sectors rather than reducing attendance overall. Cellini (2009) provides further evidence of substitutability by showing that

enrollment in California community colleges increased after the passage of a local bond measure, while the number of nearby for-profit colleges declined. Notably, the enrollment shift occurred before revenue from local bond measures could be used to expand public-sector capacity, suggesting an informational effect of the bond measures on students' enrollment decisions.

A concern with policies that shift enrollment away from FPCs is that this could cause a shift in students' fields of study. For example, Gilpin, Saunders, and Stoddard (2015) find that enrollment and degree completion by field are more responsive to employment growth at FPCs than at public colleges. But there is substantial overlap in the fields offered across sectors (Cellini and Turner 2016), suggesting that limiting access to FPCs may not substantially harm student choices of field or major. Moreover, if FPCs take advantage of their flexibility to offer programs in high-demand fields, we would expect to see this flexibility reflected in student outcomes. But as noted above, studies of earnings and employment outcomes consistently fail to find evidence that FPC students perform better than comparable students from public colleges, and if anything, they perform worse. Thus, even if there is a benefit of FPC flexibility, all else equal, other aspects of the training appear to more than offset the gains.

Finally, another important area of study is the responsiveness of FPCs to federal student aid dollars, which account for a substantial fraction of revenue for many FPCs. There is suggestive evidence that FPCs open in low-income areas where they can maximize the number of federal student aid recipients (Cellini 2010), and work by Cellini and Goldin (2014) implies that FPCs raise tuition above the cost of providing education to capture federal aid dollars. The latter study shows that tuition at FPCs that receive federal student aid is nearly 80 percent higher than at FPCs with similar programs that do not have access to these funds. This study also documents the existence of thousands of FPCs that operate without access to federal student aid programs.

Policy Recommendations

We recommend that policymakers build on recent efforts to strengthen accountability for FPCs. This recommendation is based on mounting evidence demonstrating that students who attend FPCs have similar or worse labor market outcomes, substantially higher debt and loan default rates, and report less satisfaction with their postsecondary education.

An effective and ready policy lever available to federal officials is institutional access to revenue subsidies via federal student aid programs (Cellini and Koedel, forthcoming). For-profit colleges are heavily reliant on federal dollars flowing through these programs. On average, FPCs that are eligible for Pell Grants and student loans under Title IV of the Higher Education Act receive 70 percent of their total revenue from the Department of Education through these programs.³ Moreover, this high number does not include funding from the GI Bill and other programs administered through the US Department of Veterans Affairs and US Department of Defense. Despite being private organizations, many FPCs rely primarily on public resources for funding.

For policymakers interested in infusing private-market incentives into higher education, the justification for spending federal dollars to support FPCs is unclear. We ask policymakers to consider

the following question: Should federal funding be used to support profit-seeking institutions—in any market—without clear evidence of value? In the case of FPCs, there is no compelling evidence that they provide efficacious programs, and to the contrary the results of recent research suggest otherwise. We believe FPC programs should have to show their value in the form of positive student outcomes or unsubsidized paying customers to gain access to federal student aid.

In terms of concrete policy recommendations, we turn first to the gainful employment rule—enacted in 2014—requiring graduates of each program within an institution to meet certain debt-to-earnings ratios to maintain eligibility for federal student aid. We urge that enforcement of the GE rule move forward without further delay to protect students and save taxpayer dollars. And although we view it as unlikely in the current political climate, we support expanding the GE rule to hold institutions accountable for the roughly for 40 percent of students who do not graduate, but may nonetheless incur substantial debt (Snyder, de Brey, and Dillow 2016, table 326.20).

Policymakers will also have an opportunity to change the rules governing federal aid to FPCs as the Higher Education Act comes up for reauthorization. The “90-10 rule” could be amended. The current rule requires that no more than 90 percent of FPC revenues come through Title IV federal student aid programs for an FPC to be aid eligible. But revenues from other federal sources are not counted toward the 90 percent cap. A simple policy recommendation is to fold all federal revenue sources into the rule, which would reduce the incentive of FPCs to target veterans and would protect taxpayer dollars. It could also be amended to require that 10 percent of students agree to pay full tuition without federal aid, rather than allowing all students to pay just 10 percent of the total, as under the current rule. This is consistent with the spirit of the rule and with the behavior of private firms in nearly all other markets that rely on paying customers to indicate value.

Institutional risk sharing is another promising policy option. Several approaches to risk sharing have been proposed (Webber, n.d.),⁴ but the idea is generally the same: institutions would be required to pay the Department of Education a percentage of the value of loan balances with negative outcomes. The more costly an institution’s previous loans, the more that institution would pay. A benefit of this type of risk sharing is that it moves toward internalizing student incentives for institutions. Our view is that FPCs should not be eligible to participate in Title IV or veterans benefits without sharing the risk that students take with their educational investments.

An appeal of the GE regulations and risk-sharing policies is that they help align the incentives of institutions with those of students. But they may also create perverse incentives and result in unintended consequences. One concern is that FPCs may avoid enrolling students deemed too risky. To avoid this, we support proposals that couple restrictions on aid access with a per student bonus paid to institutions for each at-risk student who graduates and repays his or her loan (Webber, n.d.).

Another concern with stricter accountability measures is that FPCs may attempt to dodge regulations by converting to nonprofit status. On one hand, these conversions could be beneficial because nonprofit institutions must reinvest profits into the organization, and such a change could prompt better alignment between institutional and student incentives. But on the other hand, in several

recent conversions, the sale and governance structure of the nonprofit appears to have served primarily to enrich CEOs and board members while circumventing regulations.⁵ We urge the current administration to scrutinize proposed conversions and governing boards for signs of impropriety or financial conflicts of interest.

In sum, current policies allow FPCs to access billions of dollars in federal student aid without requiring a high-quality product, resulting in a sector that is far from the private-market ideal for fostering innovation and productivity. For-profit college students have disappointing labor market outcomes and a large number of students take on debt they cannot reasonably repay. At this crucial crossroads, we urge greater accountability in for-profit higher education to protect both students and taxpayers.

Notes

1. For details of previous cycles, see David Whitman, “Truman, Eisenhower, and the First GI Bill Scandal,” The Century Foundation, January 24, 2017, <https://tcf.org/content/report/truman-eisenhower-first-gi-bill-scandal/>; David Whitman, “Vietnam Vets and a New Student Loan Program Bring New College Scams,” The Century Foundation, February 13, 2017, <https://tcf.org/content/report/vietnam-vets-new-student-loan-program-bring-new-college-scams/>; and David Whitman, “When President George H. W. Bush ‘Cracked Down’ on Abuses at For-Profit Colleges,” The Century Foundation, March 9, 2017, <https://tcf.org/content/report/president-george-h-w-bush-cracked-abuses-profit-colleges/>.
2. “Official Cohort Default Rates for Schools,” US Department of Education, Office of Federal Student Aid, last updated September 28, 2016, <https://www2.ed.gov/offices/OSFAP/defaultmanagement/cdr.html>.
3. Authors’ tabulations of Department of Education 90-10 Data. See US Department of Education, “New Analysis Finds Many For-Profits Skirt Federal Funding Limits,” press release, December 21, 2016, <https://www.ed.gov/news/press-releases/new-analysis-finds-many-profits-skirt-federal-funding-limits>.
4. See also Beth Akers, “Risk-sharing: An efficient mechanism for funding student loan safety nets,” Brookings Institution, December 19, 2016, <https://www.brookings.edu/research/risk-sharing-an-efficient-mechanism-for-funding-student-loan-safety-nets/>; and Ben Miller and CJ Libassi, “Sharing the Risk: A Plan for Colleges to Participate in the Costs of Student Loan Failure,” Center for American Progress, December 19, 2016, <https://www.americanprogress.org/issues/education/reports/2016/12/19/295187/sharing-the-risk/>.
5. Andrew Kreighbaum, “No Dice for Nonprofit Conversion,” *Inside Higher Ed*, August 12, 2016, <https://www.insidehighered.com/news/2016/08/12/departments-education-denies-profit-colleges-application-nonprofit-status>.

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