For-Profit Colleges

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Accessibility
For-Profit Colleges

David Deming, Claudia Goldin, and Lawrence Katz

Summary

For-profit, or proprietary, colleges are the fastest-growing postsecondary schools in the nation, enrolling a disproportionately high share of disadvantaged and minority students and those ill-prepared for college. Because these schools, many of them big national chains, derive most of their revenue from taxpayer-funded student financial aid, they are of interest to policy makers not only for the role they play in the higher education spectrum but also for the value they provide their students. In this article, David Deming, Claudia Goldin, and Lawrence Katz look at the students who attend for-profits, the reasons they choose these schools, and student outcomes on a number of broad measures and draw several conclusions.

First, the authors write, the evidence shows that public community colleges may provide an equal or better education at lower cost than for-profits. But budget pressures mean that community colleges and other nonselective public institutions may not be able to meet the demand for higher education. Some students unable to get into desired courses and programs at public institutions may face only two alternatives: attendance at a for-profit or no postsecondary education at all.

Second, for-profits appear to be at their best with well-defined programs of short duration that prepare students for a specific occupation. But for-profit completion rates, default rates, and labor market outcomes for students seeking associate’s or higher degrees compare unfavorably with those of public postsecondary institutions. In principle, taxpayer investment in student aid should be accompanied by scrutiny concerning whether students complete their course of study and subsequently earn enough to justify the investment and pay back their student loans. Designing appropriate regulations to help students navigate the market for higher education has proven to be a challenge because of the great variation in student goals and types of programs. Ensuring that potential students have complete and objective information about the costs and expected benefits of for-profit programs could improve postsecondary education opportunities for disadvantaged students and counter aggressive and potentially misleading recruitment practices at for-profit colleges, the authors write.

www.futureofchildren.org

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DURING THE PAST FIFTEEN YEARS, YOUTH FROM MINORITY AND DISADVANTAGED BACKGROUNDS AND THOSE ILL-PREPARED FOR COLLEGE INCREASINGLY AND DISPROPORTIONATELY HAVE ENROLLED IN PROGRAMS AT FOR-PROFIT COLLEGES. THESE PROGRAMS PROMISE MUCH, ARE OFTEN OPEN TO THOSE WHO DO NOT MEET TRADITIONAL COLLEGE-ENTRY REQUIREMENTS, AND ARE LARGELY FUNDED BY FEDERAL STUDENT FINANCIAL AID, PARTICULARLY FEDERAL GRANTS AND LOANS. WE ANALYZE THE RAPID GROWTH OF FOR-PROFITS, LOOK MORE CLOSELY AT THE STUDENTS WHO ENROLL IN THEM, AND ASSESS THEIR ROLE IN PROVIDING THE SKILLS OF TOMORROW TO THE YOUTH OF TODAY.

WHAT ARE FOR-PROFIT COLLEGES?

FOR-PROFIT SECTOR INSTITUTIONS ARE A VARIED GROUP. THE SECTOR CONTAINS THE LARGEST SCHOOLS BY ENROLLMENT IN THE UNITED STATES AND ALSO SOME OF THE SMALLEST. FOR EXAMPLE, THE UNIVERSITY OF PHOENIX ONLINE PROGRAM ENROLLED MORE THAN 532,000 STUDENTS DURING THE 2009 ACADEMIC YEAR, AND THE LARGEST FIFTEEN INSTITUTIONS, TAKEN TOGETHER, ACCOUNT FOR ALMOST 60 PERCENT OF FOR-PROFIT ENROLLMENTS.1 YET, IN THE FALL OF 2009, THE MEDIAN ENROLLMENT IN ALL FOR-PROFIT INSTITUTIONS ELIGIBLE TO ACCEPT FEDERAL STUDENT AID UNDER TITLE IV OF THE HIGHER EDUCATION ACT WAS JUST 172 STUDENTS.2 FOR-PROFIT SCHOOLS, ALSO KNOWN AS PROPRIETARY INSTITUTIONS, OFFER A WIDE ARRAY OF PROGRAMS, FROM DOCTORATES TO CERTIFICATES EARNED IN A YEAR OR LESS, IN FIELDS RANGING FROM HEALTH CARE AND BUSINESS TO INFORMATION TECHNOLOGY AND GRAPHIC DESIGN TO COSMETOLOGY AND COOKING.

THE FOR-PROFIT SECTOR HAS EXISTED FOR MORE THAN A CENTURY IN THE FORM OF “CAREER COLLEGES,” PROPRIETARY INSTITUTIONS THAT MOSTLY HAVE OFFERED SHORT COURSES IN APPLIED FIELDS AND SERVED LOCAL LABOR MARKETS. YET, TODAY, FOR-PROFIT HIGHER EDUCATION HAS BECOME, IN MANY PEOPLE’S MINDS, SYNONYMOUS WITH LARGE BRAND-NAME INSTITUTIONS THAT HAVE RAPIDLY EXPANDED THEIR PRESENCE IN THE BACHELOR’S DEGREE AND GRADUATE EDUCATION MARKETS. FOR-PROFIT CHAINS Led BY ONLINE INSTITUTIONS HAVE EXPERIENCED PHENOMENAL GROWTH IN THE PAST SEVERAL DECADES.3 ENROLLMENT IN THE FOR-PROFIT SECTOR HAS MORE THAN TRIPLED SINCE 2000, AND LARGE NATIONAL CHAINS ARE RESPONSIBLE FOR NEARLY 90 PERCENT OF THIS INCREASE.4 Thus the current incarnation of the for-profit sector is big business; the sector’s largest providers are highly profitable, publicly traded corporations.5

IN THE PAST DECADE, THE FEDERAL GOVERNMENT HAS GREATLY EXPANDED THE FUNDING OF STUDENT AID UNDER TITLE IV TO INCREASE ACCESS TO POSTSECONDARY EDUCATION. FROM 2000–01 TO 2010–11, REAL FEDERAL EXPENDITURES ON THE PELL GRANT PROGRAM MORE THAN TRIPLED FROM $10 BILLION TO $35 BILLION (IN 2010 DOLLARS) AND REAL STAFFORD LOAN VOLUMES MORE THAN DOUBLED FROM $37 BILLION TO $86 BILLION.6 IN CONTRAST, FROM 2000 TO 2010, STATE TAX APPROPRIATIONS FOR HIGHER EDUCATION INCREASED BY ONLY ABOUT 5 PERCENT IN REAL TERMS, WITH ZERO REAL GROWTH SINCE 2007.7 Thus, the large recent increase in federal higher education spending has coincided with a tightening of state budgets.

IN THE FACE OF SLUGGISH GROWTH IN STATE FUNDING FOR PUBLIC INSTITUTIONS, FOR-PROFIT COLLEGES HAVE GROWN RAPIDLY TO MEET DEMAND AND HAVE TAKEN ADVANTAGE OF EXPANDED FEDERAL STUDENT AID. PROPRIETARY INSTITUTIONS INCREASED THEIR SHARE OF THE TOTAL FALL ENROLLMENT IN TITLE IV–ELIGIBLE INSTITUTIONS FROM ABOUT 4 PERCENT IN 2000 TO NEARLY 11 PERCENT IN 2009.8 FOR-PROFIT COLLEGES WERE RESPONSIBLE FOR NEARLY 30 PERCENT OF THE TOTAL GROWTH IN POSTSECONDARY ENROLLMENT AND DEGREES AWARDED IN THE FIRST DECADE OF THE TWENTY-FIRST CENTURY.9
Finely attuned to the marketplace, the for-profits are quick to open new schools, hire faculty, and add programs that train students for jobs in fast-growing areas such as health care and information technology. They provide identical curriculum and teaching practices at multiple locations and at convenient times, and they offer highly structured programs that make timely completion feasible. In principle, such responsiveness to employer and student demand leads to greater innovation and efficiency in the marketplace for higher education. Yet the vast bulk of revenue among large for-profit chains derives from federal student aid, potentially reducing customer (student) sensitivity to price and quality. Many of the chains have developed business strategies that involve heavy investments to expand enrollment. Indeed, audit studies have shown that some for-profits have engaged in highly aggressive recruiting techniques, some of which border on fraudulence.

The snippets of available evidence suggest that the economic returns to students who attend for-profit colleges are lower than those for public and nonprofit colleges. Moreover, default rates on student loans for proprietary schools far exceed those of other higher-education institutions. Although for-profit colleges have had strong financial incentives to innovate in ways that increase enrollments, the rapid growth of the sector may have eroded program quality. A challenge for federal regulation of the for-profit sector is to design incentives for improved quality, while still preserving access for students from disadvantaged and nontraditional backgrounds.

Who Are the Students?
Students in for-profit colleges are disproportionately older (65 percent are twenty-five or older), African American (22 percent), and female (65 percent). For-profit colleges also enroll a more disadvantaged group of beginning undergraduates than do other postsecondary schools. Student characteristics can be gleaned from the Beginning Postsecondary Students (BPS) longitudinal survey for 2004–09. This survey follows a nationally representative sample of first-time, full-year undergraduates who began their postsecondary schooling in the 2003–04 academic year. For-profit colleges, particularly those that specialize in online education, also enroll many part-time and returning students. These two groups are not represented in the BPS data, however, and the comparisons below do not apply to them.

Only 75 percent of first-time undergraduates enrolled in for-profit colleges have a high school diploma, compared with 85 percent of students in community colleges and 95 percent in public or nonprofit four-year colleges (most of the other undergraduates have a General Educational Development diploma, or GED). Dependent students in for-profit colleges have about half as much family income as students in community colleges and nonselective four-year public or private nonprofit colleges. Finally, students in for-profits are two and half times more likely than community college students to be single parents (29 percent versus 12 percent). Despite the low-income status of most of their clientele, for-profit colleges are far more expensive than their counterparts in the public and nonprofit sectors. The first two sets of bar graphs in figure 1 show differences in net tuition (tuition minus grants) by type of institution and in the average Pell Grant award for BPS students in 2003, their first year of enrollment. (The figure excludes selective four-year institutions to which most students at for-profits would not be admitted.) Net tuition at proprietary schools averaged a bit more than $5,500 in
2003, compared with just under $3,500 at nonselective four-year public and nonprofit colleges, and less than $750 at community colleges. The average Pell Grant award for students at for-profits (including those not receiving grants) was $2,149, more than three times the average award for students in community colleges and twice as large as that for students in nonselective four-year schools.

Students leave for-profit colleges with higher levels of debt than students from the other types of institutions and are more likely to default on their student loans (see the last two bar graphs in figure 1). Six years after initial enrollment, students at nonselective four-year colleges have federal student loan balances similar to those of students at for-profits ($8,153 and $7,460, respectively). But many for-profit students enroll in just one- or two-year programs. Therefore, the debt burden per year of postsecondary education is higher at the for-profit institutions. Nearly 20 percent of first-time undergraduates at for-profits default on a federal loan within six years of enrollment, compared with 7 percent and 6 percent for borrowers at nonselective four-year and community colleges, respectively.

Mean differences in degree and certificate attainment, employment, earnings, and satisfaction by institution type are shown in
Figure 2. Student Outcomes by Type of Institution


Note: Figures are weighted to be nationally representative of first-time, full-year undergraduates in fall 2003. Certificate completion covers only students starting in certificate programs; associate’s or more completion covers those starting in associate’s programs; and bachelor’s covers those starting in bachelor’s programs. The unemployed and earnings measures exclude students who report that they are still enrolled in school in spring 2009. To be able to include all variables on the same chart, earnings are scaled by 100,000; for example, $20,000 is 0.2. See table 1 for definition of nonselective four-year institutions.

figure 2. About 54 percent of students who initially seek to enroll in certificate programs at for-profit colleges complete their course of study within six years, compared with just 42 percent at community colleges. Seekers of an associate’s degree are more likely to complete their degree if they enroll in a for-profit college than in a community college. But because some community college students who originally enrolled in an associate’s program go on to complete a bachelor’s degree, there is no overall difference in any degree completion among associate’s degree seekers at the two types of institutions. Only 26 percent of bachelor’s degree seekers in for-profit colleges complete within six years, compared with 53 percent at nonselective four-year public and nonprofit institutions.

Students who attended for-profit colleges are more likely to be unemployed and have lower earnings once they leave school than those in community colleges and other nonselective institutions. Six years after initial enrollment, 23 percent of students who had graduated or otherwise left for-profit colleges were unemployed and seeking work compared with about 15 percent in the other institutions. Among the employed, for-profit students had modestly lower earnings than those from...
other sectors—$28,000 compared with about $31,000 for students from the comparison institutions. Students in the for-profit sector were less satisfied with their programs. Only 65 percent felt their “education was worth the cost” compared with about 80 percent in nonselective publics and nonprofits.

Although the comparisons are made across students in programs of different length, the main conclusions hold within certificate, associate's degree, and bachelor's degree programs, and the results are similar when alternative measures of employment and satisfaction are used.18

Economic Returns to Attending a For-Profit Institution

Do higher default and unemployment rates mean that for-profit colleges are failing students? Not necessarily. Students in for-profits tend to be in more precarious financial situations than other students before they enroll. Many of those from for-profits who defaulted on their loans or were unable to find work might have been in the same predicament even if they had attended a public or nonprofit institution. For-profit college leaders and their advocates argue that a fair comparison of loan default rates and other outcomes across types of institutions must account for differences in the characteristics of incoming students.19

In earlier work, we compared student outcomes across institutions after adjusting for type of degree or certificate program, degree expectations, and a wide range of student background characteristics, using both ordinary least squares regression and matching models.20 Four main findings emerged. First, the cumulative federal student loan balances and the student loan default rates remained substantially higher for students attending for-profits than for “comparable” students attending public and private nonprofit institutions.

Do higher default and unemployment rates mean that for-profit colleges are failing students? Not necessarily. Students in for-profits tend to be in more precarious financial situations than other students before they enroll.

Second, we found that for-profit colleges do a good job of graduating students from certificate and associate’s programs but a poor job of graduating them from bachelor’s programs within six years. Third, adjusting for student background characteristics and income before enrollment narrowed the gap in post-school employment and earnings outcomes by about 50 percent but did not eliminate it. Students in for-profit colleges still had lower earnings and were less likely to be employed six years after their initial enrollment, overall as well as within the certificate and degree groups. Fourth, statistical adjustment did not noticeably narrow the satisfaction gap for students in for-profit colleges; these students were still far less likely to be satisfied with their education or to believe that it was worth the financial investment.

Overall, little solid evidence exists on the economic returns to a for-profit education.
Existing research on this question combines two related approaches: analyses of the change in earnings for individual students measured before and after attending a for-profit institution, and comparisons of the earnings outcomes for students attending for-profits to those attending other postsecondary institutions.

Using the same 2004–09 BPS data source as we do here, Kevin Lang and Russell Weinstein found that, six years after program entry, those who had completed a certificate at a for-profit institution had no increase in earnings compared with students who began the course but did not complete it.21 Lang and Weinstein also found that those who completed an associate’s program at a for-profit school had only modest (and not statistically significant) earnings increases relative to those who did not complete it. In contrast, they find large positive and statistically significant earnings increases for students completing an associate’s degree in a public or nonprofit institution.

Using administrative panel data on earnings and enrollment from the Internal Revenue Service for a sample of 45 million individuals who enrolled as undergraduates from 1999 to 2008, Nicholas Turner found smaller returns for students in for-profit colleges compared with other types of institutions in a framework that compared earnings before and after attendance.22 In contrast, Stephanie Cellini and Latika Chaudhary compared the earnings trajectories of students from private and public two-year institutions using panel data from the 1997 National Longitudinal Survey of Youth and found that students completing an associate’s degree at two-year private (mainly for-profit) colleges had about the same earnings increases as similar students at two-year public institutions.23

We draw several conclusions from the nascent literature on economic returns to a for-profit education. Students attending for-profits wind up earning less than students from other types of institutions, and the change in their earnings after attending a for-profit appears to be less than or similar to the change in earnings from attending a nonprofit or public institution. The combination of equal or lower benefits and a higher cost of attendance suggests that for-profit institutions are not offering students as good a return on their investment as do other types of colleges. But because none of these studies has a strong experimental or quasi-experimental design, they should be used with caution. More research and more data are needed.

Because of data limitations, the existing literature has focused on overall mean comparisons of outcomes for students by college institutional control rather than by specific program. It is likely that some certificates and degrees awarded by for-profits are a good investment, whereas others are not. Future research should examine the extensive heterogeneity in programs in the for-profit sector.

Why Do Students Enroll in a For-Profit Institution?
Taking the evidence above at face value, we ask: If for-profit education is not a good investment relative to that from other types of institutions, why has for-profit enrollment grown so fast? Several explanations are possible.

Keeping Up with Employer Demand
For-profit colleges often specialize in short programs that are narrowly focused toward preparation for particular occupations. Because of that, they are often called career colleges. In the for-profit sector, an associate’s degree typically serves as the terminal
credential for a particular occupation, whereas in the public and nonprofit sectors it is often a gateway to a four-year degree. Thirty-eight percent of associate’s degrees granted by public and nonprofit institutions, but just 2 percent granted by for-profits, are in general studies and liberal arts. For-profits specialize in particular associate’s degree programs. They produce 18 percent of all associate’s degrees but account for 33 percent of those granted in business, management, and marketing; 51 percent in computer science; and 23 percent in the health professions.

Many students in for-profit colleges enroll in short programs with a clearly defined curriculum (often geared toward training students to pass an occupational licensing exam) and specific job placement goals. To succeed, such programs must have close connections with industry, provide active help with job placement, and be able to adjust instruction rapidly to the changing needs of employers. Institutions must also be able to alter staffing and other resources to accommodate increases in demand for popular programs. For-profit colleges may do a better job than other institutions in expanding capacity in highly demanded occupations where jobs are plentiful. Furthermore, Sarah Turner found that for-profits are more responsive than public institutions in adjusting their enrollment capacities to indicators of aggregate student demand such as changes in the college-age population in a state.

Do students choose for-profit colleges because they offer programs that are more closely attuned to the current needs of employers? Do for-profits perform relatively better within these groups of programs? We address these questions by focusing on the health professions.

For-profits have moved nimbly into the health professions where job opportunities have been expanding. Ten of the twenty fastest-growing occupations in the United States are related to health care. Much of this growth has come in allied health care support occupations such as medical assistants, phlebotomists, and X-ray and ultrasound technicians, for which an associate’s degree or a certificate is usually sufficient for employment. Not surprisingly, given rapidly growing employer demand, overall postsecondary enrollment in health-related programs has doubled during the past decade. Growth has been relatively faster among for-profits—just over half of all students enrolled in such programs in 2009 were attending for-profits, compared with 35 percent in 2000. In the 2008–09 academic year, programs in the health professions made up the single largest field of study in for-profit colleges and the second-largest in community colleges.

How do these students fare in the labor market? Figure 3 compares outcomes for students enrolled in allied health programs in community colleges and for-profits. The pattern of results is qualitatively similar to those already seen for differences by type of institution across all programs. Student loan default rates are slightly lower in the health professions than overall, but the students in health fields at for-profits have a similarly higher default rate than those from community colleges as they do overall. The for-profit advantage is only about 2 percentage points for certificate completion in health programs and is reversed for associate’s degree completion in these areas. In fact, students in a community college health program are more than twice as likely to complete their associate’s degree than are students in health programs at a for-profit institution (35 versus 17 percent).
Unemployment rates within each institution type are about 5 percentage points lower for the health professions than for all programs combined (compare figures 2 and 3). Still, students from for-profit health programs are more than twice as likely as students from community college programs to be unemployed (19 versus 9 percent), and those that are employed have about 12 percent lower earnings. Satisfaction rates for health programs are considerably higher than average, but the gap between community colleges and for-profits is still about 14 percentage points. In results not shown, we confirm that statistical adjustment for student characteristics does little to change the magnitude of these differences.

In sum, we find that students enrolled in health-related programs at for-profit colleges have worse outcomes than community college students in similar programs. Based on these results, we conclude that the focus of for-profits on fast-growing occupations is unlikely to fully explain why a student would choose to enroll in a for-profit college if the student also had access to a comparable community college program.
Although much of the growth in for-profit college enrollment has come from online education, community colleges also offer many classes online. In fact, among first-time undergraduates in 2003, more than 13 percent of students at community colleges reported taking at least one class online, compared with only about 6 percent of students at for-profit colleges.

Better Guidance and Student Services
Another explanation for the popularity of the for-profits is that even though they offer programs similar to those at community colleges, the for-profits provide a more structured, supervised approach. In a comparative study of colleges in a major city, James Rosenbaum, Regina Deil-Amen and Ann Person found that students at what they call “private occupational colleges” (meaning for-profit, proprietary, or career colleges) had higher completion rates than students at community colleges. The researchers demonstrated that, compared with community colleges, private occupational colleges undertook a more active role in guiding students through the process of enrollment and completion and that they more aggressively assisted with job search. But that conclusion seems at odds with the finding that students at for-profit colleges have worse employment outcomes and are less satisfied with their programs.

One possible explanation, which the researchers themselves advanced explicitly, is that their study of a group of particularly strong private occupational colleges does not generalize to the for-profit sector overall. In addition, their study took place between 2000 and 2002 at the beginning of the rapid rise in for-profit college enrollment, and they did not study the chain institutions in which most of the recent enrollment growth has been concentrated. Thus, the lessons they drew from comparing for-profits to community colleges may not hold today or for the for-profit sector as a whole.

A related possibility is that for-profit colleges do a better job of accommodating the busy schedules of older students by offering courses at flexible times such as nights and weekends. However, community colleges also offer courses at all hours. In 2009, the New York Times reported that some community colleges were holding classes nearly twenty-four hours a day to respond to enrollment spikes brought about by the economic recession. Bunker Hill Community College in Massachusetts offered classes from midnight to 2:30 a.m., as did Clackamas Community College in Oregon. Many other schools started their classes as early as 6 a.m.

Although much of the growth in for-profit college enrollment has come from online education, community colleges also offer many classes online. In fact, among first-time undergraduates in 2003, more than 13 percent of students at community colleges reported taking at least one class online, compared with only about 6 percent of
students at for-profit colleges. By fall 2011, 46 percent of community college students reported taking at least one class online.\textsuperscript{30}

**Overcrowding at Community Colleges**

Students might turn to for-profit colleges because local community colleges are overcrowded or otherwise unable to meet their needs. The past decade has seen stagnant or declining state funding of community colleges coupled with a growing demand for postsecondary education. With their open-access mission, community colleges face enormous pressure to accommodate more students despite having fewer dollars to do so. Not surprisingly, overcrowding of popular courses and programs has resulted. According to a nationally representative survey of U.S. community college students, 37 percent reported that they had been unable to enroll in at least one course during the fall 2011 semester because it was full, and 20 percent reported that they would have trouble enrolling in courses required for their degree or certificate.\textsuperscript{31}

Even if students are able to enroll in a community college, they may have to take some remedial courses before they are able to start working toward a degree. Compared with for-profits, community colleges are more likely to require students to take remedial courses, which do not count toward a degree. Less than 8 percent of first-time undergraduates in for-profit colleges enrolled in remedial coursework in 2003–04, compared with nearly 30 percent in community colleges.

Lower rates of remediation at the for-profit institutions could reflect lower academic standards. On the other hand, the system adopted by many community colleges of assigning students to remedial coursework based on performance on a standardized placement exam might be an inefficient use of resources. Students might turn to for-profit colleges for short programs, seeking to avoid extensive remediation at community colleges that could double the time it takes for them to earn a degree.\textsuperscript{32}

Higher education funding in California provides an instructive case study of how for-profit colleges might step into the vacuum created by shrinking public budgets. In response to an anticipated cut of $825 million in 2009, the community colleges of California capped enrollment growth, cut hundreds of courses, and imposed a hiring freeze on lecturers and support staff.\textsuperscript{33} In fall 2009, the California Community Colleges Chancellor’s Office announced a partnership with Kaplan University, a large and predominately online for-profit university owned by the Washington Post Company, which is publicly traded. The agreement allowed students at certain community colleges to take online courses from Kaplan and receive credit that would transfer back to their institution.

Even though Kaplan gave California students a 42 percent discount, a three-credit course was still about eight times as expensive as one at a California community college ($645 versus $78).\textsuperscript{34} The agreement lasted less than a year, mainly because community colleges were unable to guarantee that public four-year colleges in California would accept transfer credits from Kaplan. Still, Kaplan made inroads with community college students. Shortly after announcing the agreement, the for-profit created a new scholarship program “designed to help students affected by the fiscal crisis plaguing California’s state college system.”\textsuperscript{35}

The best evidence on the impact of state budgetary difficulties on students’ enrollment...
choices comes from Stephanie Cellini, who found that for-profit colleges in California were more likely to enter local markets after community college bond referendums failed to pass. With a strong research design based on a comparison of communities where bond initiatives barely failed to those where they barely passed, this study provides strong causal evidence of the connection between constraints on public sector funding and the growth of for-profit institutions.

Marketing and Recruitment Activities of For-Profit Colleges
A further possibility is that, in the face of limited information on the costs and benefits of different programs, student enrollment decisions may be greatly influenced by the advertising and recruiting efforts of for-profit colleges. All postsecondary institutions eligible for federal student grants and loans, including for-profits, are responsible for putting together a student’s financial aid package from a mix of federal and state aid, institutional grants, and federal and private loans. Once schools assemble this information, it is presented to the student, who then decides whether to enroll (see the article on financial aid in this issue by Susan Dynarski and Judith Scott-Clayton). Institutional control of the assembly of financial aid packages has advantages given the complexity of the financial aid system. Yet it also creates potential conflicts of interest for the institution and incentives for aggressive and deceptive recruiting practices, especially if employee compensation is based on success in attracting students and getting the federal student aid that comes with them.

As early as 1991, the federal government attempted to regulate the use of incentive compensation for employees of for-profit colleges. The Higher Education Amendments of 1992 banned for-profit colleges from paying commissions, bonuses, or any other form of compensation that is tied to enrollment or financial aid. Beginning in 2002, the ban on incentive compensation was gradually weakened by the creation of twelve “safe harbor” exceptions to the rule. For-profit colleges were permitted, for example, to adjust the wages of recruiters twice a year, so long as the adjustment was not “based solely on the number of students recruited, admitted, enrolled, or awarded financial aid.”

A report issued in 2010 by the Government Accountability Office (GAO) revealed direct evidence of troubling recruiting practices at for-profit colleges. The GAO sent investigators posing as prospective students to fifteen proprietary colleges and recorded their encounters with admissions personnel at each college. The colleges were not a random sample of for-profits. Rather, the GAO chose a mix of privately owned and publicly traded schools of various sizes, all of which either received 89 percent or more (the legal limit is 90 percent) of their revenue from Title IV federal aid or were located in a state that was among the top ten recipients of Title IV funding.

According to the GAO investigators, officials at four of the fifteen schools encouraged applicants to engage in outright fraud, such as not reporting savings, in order to qualify for federal financial aid. Personnel at all fifteen colleges made “deceptive or otherwise questionable” statements to undercover applicants. Examples included failing to provide information about the college’s costs and past graduation rates (federal regulations require them to report this information) and understating tuition by using the cost for nine months of attendance when the program actually ran for twelve months. Some admissions staff pressured applicants to sign a
contract before allowing them to speak with a financial adviser.

Many for-profit colleges devote considerable resources to advertising, sales, and marketing. GAO investigators posing as prospective students entered their personal information on websites designed to match students to colleges based on their stated interests. These investigators were contacted repeatedly, some within five minutes of signing up. One received more than 180 phone calls in one month from a for-profit recruiter. Advertisements for proprietary institutions can be seen regularly on television, in subway stations and trains, and on interstate highway billboards. According to one study, thirteen large publicly traded for-profit institutions spent around 11 percent of revenue in 2009 on advertising. Altogether, about 24 percent of revenue was spent on sales and marketing (including advertising). The cost to recruit the average new student at a large national chain is around $4,000, or about 25 percent of average annual tuition.39

The combination of for-profit institutions’ reliance on federal financial aid and use of incentive compensation in enrolling students creates incentives for overly aggressive student recruitment. In the 2009–10 fiscal year, 75 percent of revenues at for-profit institutions came from Title IV funding.40 Federal regulation prevents for-profit colleges from relying on Title IV sources for more than 90 percent of revenue, and many large chains such as University of Phoenix (86 percent) and Kaplan University (87 percent) are very close to the statutory limit. Publicly traded companies that rely heavily on federal financial aid also have a fiduciary duty to maximize value for their shareholders. Expanding enrollment to capture the federal student aid of marginal students unlikely to benefit economically from a program could prove to be a profitable strategy. When such institutional incentives are combined with outreach to low-income, first-generation college students who may be financially unsophisticated, the worry is that students may have overly optimistic views of the expected benefits and not fully understand the costs (for example, the difference between loans and grants) of the educational decisions they are making.

Career Orientation of For-Profit Colleges
The career-oriented approach and wide range of specific occupational training offered by for-profit colleges attract many students. But this focus comes with some costs, especially for first-time postsecondary students. Learning about one’s own abilities and preferences to be able to make better-informed decisions about further education and career is a valuable part of initial college experiences. And such opportunities for exploration are more limited at for-profits. Part of the mission of a community college is to provide open access to a general liberal arts curriculum at a low cost so that students can learn whether a four-year degree is right for them. By not saddling students with high debt burdens, community colleges preserve the “option value” of further postsecondary education.41

Table 1 presents a transition matrix for students in the 2004–09 BPS categorized by initial program enrollment. Of all certificate seekers, 42 percent of those in community colleges and 53 percent of those in for-profits attained a certificate within six years. In addition, 41 percent of certificate seekers in community colleges, and 41 percent in for-profits, did not attain a certificate and were no longer enrolled at the end of six years. Community college students were more likely either to attain another degree or to still be enrolled (17 percent versus 6 percent).
Table 1. Transition Matrix of Initial Enrollment to Final Outcome (Percentage of those initially enrolled)

<table>
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<tr>
<th>Outcome in Spring 2009</th>
<th>Certificate</th>
<th>Associate’s degree</th>
<th>Bachelor’s degree</th>
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<td>41.9</td>
<td>53.3</td>
<td>7.2</td>
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<tr>
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<td>6.2</td>
<td>1.6</td>
<td>21.2</td>
</tr>
<tr>
<td>Attain bachelor's degree</td>
<td>1.4</td>
<td>0.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Still enrolled, four-year</td>
<td>3.4</td>
<td>1.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Still enrolled, not four-year</td>
<td>6.0</td>
<td>3.1</td>
<td>9.8</td>
</tr>
<tr>
<td>No longer enrolled</td>
<td>41.2</td>
<td>41.0</td>
<td>46.6</td>
</tr>
</tbody>
</table>

Note: Figures are weighted to be nationally representative of first-time, full-year undergraduates in fall 2003. Each column sums to 100 and reports the six-year outcomes for students who begin enrollment in the indicated program and institution type. Rows are a mutually exclusive and collectively exhaustive set of possible outcomes following initial enrollment. The BPS defines nonselective four-year institutions as either having explicitly open admission or being in the bottom 15 percent of median SAT/ACT scores and in the bottom 15 percent of the share of applicants denied admission.

This pattern is even more pronounced among those beginning associate’s programs. Students in for-profits were more likely to attain an associate’s degree (28 percent versus 21 percent in community colleges), but they were also more likely to have left school without attaining any degree (53 percent versus 47 percent). Despite lower attainment of the initially sought-after degree, community college students who began in associate’s programs were much more likely to consider it the first step of a longer educational journey. Fifteen percent of students in community colleges who initially enrolled in an associate’s degree program had either attained a bachelor’s degree or were enrolled in a four-year college at the end of six years. Lower tuition and the ability to attend school without borrowing large sums of money encourage such exploration.

In summing up the evidence on why students choose to go to for-profit schools, we reach the following conclusions. For-profit colleges offer a wide variety of programs and courses in fields that are in high demand among employers, such as health and information systems. But so do community colleges. Moreover, the two types of colleges do not seem to differ greatly in their ability to accommodate students with hectic schedules involving work and family demands. Both types of institutions offer courses at night, on weekends, and online.

The rise in for-profit enrollment coincided with the tightening of state higher education budgets and declining access to public institutions, especially community colleges. Their open-access mission means that few community colleges deny admission formally. But many students report that they are unable to register for required courses either because
the courses are full or because students must first complete (possibly needless) remedial coursework. These students may thus turn to for-profits as an alternative.

Some (perhaps many) students who choose to attend a for-profit institution may not arrive at that decision through a dispassionate and deliberate process of weighing costs and benefits. Even when costs and benefits are presented clearly and simply, education is an uncertain investment. The uncertainty is compounded by the incentives of for-profit colleges to grow student enrollment and capture the associated federal student aid dollars, and by the evidence that proprietary institutions do not always present information on financial aid packages in a neutral manner.

The GAO investigative report on recruiting practices at for-profits raises concerns that fraudulent and deceptive behaviors have been widespread. If true, many students who enroll in for-profit institutions may base their enrollment decisions on distorted information concerning the cost and expected benefits (in terms of graduation rates and future employment prospects and earnings) of their education. The GAO’s sampling method was in some ways designed to focus on schools with the strongest incentives to apply pressure in recruitment of new students. Yet the fact that official personnel at all fifteen schools made “deceptive or otherwise questionable statements” to applicants suggests that these are unlikely to have been isolated incidents.

The highly focused career- and student-centered approach of most for-profit colleges provides a possible benefit relative to community colleges. But the lack of flexibility means that for-profit students forgo the option value of further education, and the expense of their programs means that students may not have the luxury of exploring other educational and training opportunities. The flexibility of community colleges as well as their lower tuition helps to explain why their students are more likely subsequently to enroll in a four-year college and to complete a bachelors’ degree.

The failed partnership between California community colleges and Kaplan University illustrates that for-profits and community colleges often compete for the same students. It also shows that part of the enrollment growth at for-profit colleges is a consequence of declining access in the public sector. Students turn to for-profits when community colleges are unable to meet their educational needs.

The question of whether a prospective student has a choice between a for-profit and a public institution affects judgments about the relative costs and benefits of enrollment in for-profit institutions. In our earlier work, we compared outcomes of students among for-profits, community colleges, and four-year public and nonprofit schools. Our finding that students who attended for-profits have more debt and lower employment rates relative to students at the other institutions is not relevant if students lack access to appropriate programs at public colleges. A related point is that for-profit spending on advertising and marketing may well be attracting many students who would otherwise not have attended college at all. When community college is not a viable option, the relevant counterfactual to enrollment at a for-profit institution may be no postsecondary education.

For many people, a for-profit college education endows them with skills that can be put to practice in the labor market immediately
upon program completion. But the high cost of the education to the student and the modest earning opportunities offered by many of the jobs for which these schools prepare students mean that caution is advised. Such caution applies to the students themselves, as well as to taxpayers who foot part of the bill through federal student aid and a much larger part when a student ends up not paying back federal student loans.

What Is the Social Value of For-Profit Education?
Postsecondary education is financed by students and taxpayers. At public institutions, the tuition and fees paid by students are often a small fraction of the cost of providing education. State, federal, and (sometimes even) local governments pay most of the balance of the bill, often in complicated ways. Like federal Title IV aid, state appropriations for public institutions are tied to enrollment, albeit less directly.44

These state subsidies help community colleges keep tuition sufficiently low that students have relatively small average federal loan allocations. Average tuition of first-time undergraduates at community colleges in 2008 was only $1,153, compared with $10,168 at for-profit institutions.45 Only about 13 percent of community college students borrowed money to attend school, compared with more than 90 percent of students in for-profits.46 Students at community colleges and some other public institutions rely less on Pell Grants and government loans precisely because the public has already subsidized their schooling.

According to a position paper issued in 2010 by the Apollo Group, the corporation that owns and operates the University of Phoenix, for-profit colleges are a bargain for taxpayers because they cost the public “significantly less than traditional schools.”47 The report calculated the per-student taxpayer cost of a for-profit education as $4,519, compared with $11,340 for public two- and four-year institutions. The calculation included federal, state, and local government support, as well as the cost to taxpayers of loan defaults and taxes paid back on corporate profits.48

In a similar vein, Stephanie Cellini compared the costs to taxpayers and students of attending a community college as opposed to a two-year for-profit institution.49 She estimated an annual per student cost to the taxpayer of $11,387 at a community college compared with $7,637 at a for-profit. In both analyses, community colleges were more costly for taxpayers. But tuition and fees at for-profits cost the student, on average, nearly $20,000 more than they did at community colleges, making the total cost of education about $15,000 higher at a for-profit institution.

Based on these figures, Cellini estimated the “break even” social and private rates of return on investment to be 9.8 percent and 8.5 percent, respectively, at for-profits, compared with 7.2 percent and 5.3 percent at community colleges. This calculation implies that, relative to community colleges, for-profits need to generate returns that are 36 percent greater for society and 60 percent greater for individuals to be worth the cost. The relatively sparse literature on the subject has found results ranging from no significant difference in returns between the two sectors to lower relative returns among students at for-profits, suggesting that the benefits to society of for-profits do not likely outweigh the costs.50

Moreover, these comparisons of social returns do not consider any public goods
benefits of postsecondary institutions, such as research spillovers, the public use of facilities, and the civic benefits of liberal arts education. Studies of economic spillovers find substantial benefits to localities from the presence of flagship public universities and university research more generally.\textsuperscript{51} The missions of public institutions (in particular, four-year colleges and universities) often explicitly include the provision of public goods and research and extension services for local industries, whereas for-profits (even those offering bachelor’s and higher degrees) explicitly tout that their faculty focus is only on teaching.\textsuperscript{52}

**Regulation of the For-Profit Sector**

Federal regulations that govern for-profit colleges are intended to ensure that taxpayer money distributed to them is spent wisely. Thus, regulation should be designed to provide incentives to institutions to maximize the social value of the education they provide.

The federal regulations affecting for-profits concern institutional eligibility for federal (mainly Title IV) student financial aid, student outcomes for Title IV–eligible institutions, and the delivery of federal financial aid to students. The 90/10 rule tries to ensure that for-profit institutions are no more than 90 percent dependent on Title IV federal student aid as a share of their total revenues. Federally monitored student outcomes include default rates on federal student loans and, subject to ongoing judicial scrutiny, a broader range of student economic outcomes embodied in a new “gainful employment” regulation. Federal regulations also try to ensure transparency in the presentation of financial aid packages, limit the use of incentives for employees involved in student recruitment, and improve the availability of information on student graduation rates and economic outcomes.

**The 90/10 Rule**

Federal student financial aid is the lifeblood of for-profit higher education in the United States. Federal grants and loans accounted for 73.7 percent of the revenues of Title IV–eligible for-profit higher education institutions in 2008–09.\textsuperscript{53} And these figures understate the importance of federal student aid because they do not include military educational benefits.\textsuperscript{54} For-profit schools can acquire no more than 90 percent of their revenue from Title IV sources to maintain their eligibility for that aid, and the constraint comes close to binding for many for-profits, especially some of the large chains. The availability of federal student aid may contribute directly to increases in tuition prices, a conjecture known as the “Bennett hypothesis.” A recent study by Stephanie Cellini and Claudia Goldin found that tuition for certificate programs in Title IV–eligible for-profits was 75 percent higher than in comparable institutions where students cannot apply for federal financial aid.\textsuperscript{55} Related work by Cellini found that increases in the generosity of Pell Grants and other forms of student aid led to increased market entry by for-profit institutions.\textsuperscript{56}

**Cohort default rates**

Federal regulations concerning the eligibility of institutions for Title IV financial aid also try to ensure that postsecondary programs provide marketable skills and do not overburden students with financial debt. To this end, the U.S. Department of Education monitors the default rates of entering cohorts of students by institution. The cohort default rate is defined as the share of borrowers at each school who enter into repayment on federal loans during a twelve-month period and subsequently default in the next two (or three) years. Institutions with a two-year cohort default rate that exceeds 40 percent
in one year, or 25 percent for three consecutive years, lose their eligibility for Title IV aid for one to three years. The sanctioning of schools with high default rates applies to all institutions that accept Title IV money, including for-profits, community colleges, and four-year universities of all types.

Implemented beginning in the late 1980s, cohort default rate regulation led to the closing of many trade schools in the early 1990s when they were unable to retain Title IV eligibility. The official cohort default rate for all types of institutions fell from a high of 22.4 percent in 1990 to 11.6 percent in 1993 and continued downward to a low of 4.5 percent in 2003, with some of the decline probably attributable to a strengthening economy over the same period. There were concerns, however, that the low two-year default rate masked high rates of default in the third and subsequent years, as well as a rapid rise in loan deferments and forbearances. To address the perceived inadequacy of the cohort default rate definition, the Higher Education Opportunity Act of 2008 expanded the default rate window to three years starting with the 2012 cohort.

The Department of Education released trial three-year cohort default rates by institution for the years 2005 to 2008 (covering defaults from 2008 to 2011) to estimate the impact of the new regulation. For the 2008 cohort, lengthening the window from two to three years nearly doubled the default rate (from 7.0 to 13.8 percent), and the increase was particularly striking among for-profit colleges (11.6 to 25.0 percent). If the new regulations had been applied to the 2005–08 period, the number of schools facing a loss of Title IV eligibility would have increased more than tenfold (from 23 to 270). Furthermore, the share of sanctioned schools classified as proprietary institutions would have increased from 48 percent to 80 percent.

The cohort default rate is primarily a measure of the cost of Title IV loans to taxpayers. Cellini estimated that loan defaults accounted for 36 percent of the total cost of for-profit education to taxpayers. Loan defaults are also an indirect indicator of student outcomes after graduation. It is difficult to repay a loan when you are unemployed. Still, students could struggle under the weight of loan repayments without ever formally defaulting. More generally, the cohort default rate does not explicitly link the costs of postsecondary enrollment to the benefits. For example, a community college could have low loan default rates because of low tuition but also might place very few students in good jobs. The limitations of the cohort default rate measure as well as the problems in recruitment activities by for-profits documented by GAO helped motivate the more encompassing gainful employment regulations.

**Gainful Employment**

Unlike the cohort default rate regulation, the gainful employment regulation recently adopted by the U.S. Department of Education (formally known as the Gainful Employment-Debt Measures) is targeted specifically at for-profit postsecondary institutions. Under the regulation, a program is considered to lead to gainful employment if at least 35 percent of the students in each cohort are in repayment of their federal loans or if the annual loan payment for a typical student is 12 percent or less of annual earnings or 30 percent or less of discretionary income. A program that fails all three measures for three of four fiscal years would lose Title IV eligibility, which means students in the program would no longer be eligible for Pell Grants and federal student loans. The
regulation applies to all programs at for-profit institutions but only to certificate programs at public and nonprofit institutions.

According to the Higher Education Act of 1965, federal Title IV aid can be used either by students in accredited bachelor’s or associates degree programs, or at “any school that provides not less than a 1-year program of training to prepare students for gainful employment in a recognized occupation.” This statutory language provides a justification for the department’s focus on particular institutions and programs and on outcome-based measures of success in the gainful employment regulation.

The regulation is an important departure from the existing regulatory framework in at least two ways. First, it targets individual programs within institutions. The Education Department’s concern with the existing regulatory framework was that the cohort default rate, by averaging across programs within institutions, did not provide students with a good measure of the likely career prospects of individual programs. The second, and more significant, departure is its explicit link between the costs (both to students and taxpayers) and the benefits of higher education, at least as they are reflected in earnings. The regulation also tries to make available more transparent information on student program completion rates and economic outcomes to prospective students.

The future of the gainful employment regulation is uncertain. At the time of this writing, a federal district court hearing a lawsuit by the Association of Private Sector Colleges and Universities had ruled that the Department of Education failed to provide sufficient evidence to justify the loan repayment standard. The judge held that while the debt-to-income standards were based on objective criteria and research, the justification for a 35 percent repayment rate was based only on the fact that this rate identifies the bottom quarter of schools. Because the debt-to-income and repayment standards are designed to work together, the court decided that they could not be separated and thus vacated the entire ruling. As of mid-July 2012, department officials had released only a brief statement that they were “reviewing our legal and policy options.”

For the 2008 cohort, lengthening the window from two to three years nearly doubled the default rate (from 7.0 to 13.8 percent), and the increase was particularly striking among for-profit colleges (11.6 to 25.0 percent). If the new regulations had been applied to the 2005–08 period, the number of schools facing a loss of Title IV eligibility would have increased more than tenfold (from 23 to 270).

The ruling came just a few days after the department released its first round of trial data collection related to the gainful employment regulation. According to data
Table 2. Share of Programs that Fail Gainful Employment Standards (Percentage except where indicated)

<table>
<thead>
<tr>
<th>Category</th>
<th>Overall</th>
<th>Public or nonprofit</th>
<th>For-profit, independent</th>
<th>For-profit, chain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failed all three standards</td>
<td>1.4</td>
<td>0.0</td>
<td>1.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Failed annual earnings</td>
<td>2.7</td>
<td>0.0</td>
<td>3.2</td>
<td>6.5</td>
</tr>
<tr>
<td>Failed discretionary earnings</td>
<td>14.4</td>
<td>0.7</td>
<td>21.2</td>
<td>29.1</td>
</tr>
<tr>
<td>Failed repayment rate</td>
<td>10.9</td>
<td>1.0</td>
<td>12.3</td>
<td>25.7</td>
</tr>
<tr>
<td>Number of programs</td>
<td>13,772</td>
<td>5,893</td>
<td>4,380</td>
<td>3,499</td>
</tr>
</tbody>
</table>

Programs with more than thirty graduates

<table>
<thead>
<tr>
<th>Category</th>
<th>Overall</th>
<th>Public or nonprofit</th>
<th>For-profit, independent</th>
<th>For-profit, chain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failed all three standards</td>
<td>5.2</td>
<td>0.0</td>
<td>3.1</td>
<td>7.9</td>
</tr>
<tr>
<td>Failed annual earnings</td>
<td>10.0</td>
<td>0.5</td>
<td>9.4</td>
<td>12.4</td>
</tr>
<tr>
<td>Failed discretionary earnings</td>
<td>53.8</td>
<td>11.0</td>
<td>62.1</td>
<td>55.5</td>
</tr>
<tr>
<td>Failed repayment rate</td>
<td>40.5</td>
<td>15.9</td>
<td>36.2</td>
<td>48.9</td>
</tr>
<tr>
<td>Number of programs</td>
<td>3,696</td>
<td>364</td>
<td>1,495</td>
<td>1,837</td>
</tr>
</tbody>
</table>

Source: U.S. Department of Education Federal Student Aid Data Center.

Note: These data report the performance of the institutions’ 2011 graduates on the three gainful employment standards and are published for informational purposes only since the regulation does not apply to this cohort of students. The annual earnings standard requires the average annual loan payment for a cohort of students from a program not exceed 12 percent of annual earnings. The discretionary earnings standard analogously requires that the average annual loan payment not exceed 30 percent of discretionary earnings. The repayment rate standard requires that at least 35 percent of students are in repayment of their federal loans. All programs at for-profit institutions, but only certificate programs at public and private nonprofit institutions, are covered by the gainful employment regulation and included in the tabulations. The top panel includes all programs (including those with thirty or fewer students) in the tabulations and shows the share of all eligible programs that would fail each standard under the assumption that no programs with thirty or fewer graduates are counted as failing. The bottom panel shows failure rates only among programs that have more than thirty graduates. The department did not report data on at least one of the three measures for nearly 75 percent of programs because it restricts calculations to programs with more than thirty students in the relevant cohorts. The programs with missing data are small and not representative of the experience of the average student. Because enrollment data was not reported for individual programs, we could not weight the calculations by enrollment.

from students enrolled in 2011, 193 programs at ninety-three different postsecondary institutions—1.4 percent of all programs and 5.2 percent of programs with more than thirty graduates—would have failed to meet all three standards. Table 2 shows the share of programs by type of institution that would have failed each gainful employment standard. In accordance with the regulations, all programs at for-profit institutions, but only certificate programs at public and nonprofit institutions, are included in the tabulations in table 2.

Had the court upheld only the two debt-to-income standards, the failure rate would rise from 1.4 percent to 2.6 percent overall and from 5.2 percent to 9.6 percent among larger programs. Of the three standards, the annual earnings standard is by far the easiest to meet. Only 2.7 percent of all programs and 10 percent of larger programs have graduates with an average annual loan payment exceeding 12 percent of annual earnings. In contrast, the failure rates for the other two standards are much higher. Among programs with more than thirty
graduates, 53.8 percent would fail the discretionary income standard and 40.5 percent would fail the loan repayment standard. Of programs that fail the annual income standard, 95 percent also fail the discretionary earnings standard. Thus a regulation based only on the annual earnings standard would be far simpler to administer but would have an impact similar to the currently contested gainful employment standard.

The for-profit chains have the highest failure rate for the gainful employment trial standards. We define a chain as having campus branches in at least two census divisions or as operating primarily online. Nearly 8 percent of programs in chains with thirty or more graduates would have failed to meet the standards, compared with about 3 percent among independent for-profit institutions. The biggest difference comes in the loan repayment rate standard: 49 percent of larger for-profit chains would have failed compared with 36 percent of independents. Higher rates of failure for chain for-profits hold equally within major categories of programs such as health professions, business, and information technology. Programs with particularly high rates of failure include graphic design and visual arts and law enforcement and security.

The experience of the new cohort default rate regulation in the early 1990s suggests that, if and when the gainful employment regulations go into effect, they will result in some of the worst offenders being shut down, but the remaining for-profit institutions are likely to adjust quickly to the regulations. Recent evidence from the financial disclosures of publicly traded for-profits suggests that the sector may already have been affected by public scrutiny. After growth of 15 to 25 percent from 2007 to June 2010 (around the time that the GAO report and the gainful employment proposed rule were released), enrollment in thirteen large for-profits began to shrink in late 2010. By March 2011, new enrollments were down by 18 percent. In its 2011 annual report, the University of Phoenix reported that enrollment among new degree-seekers was down by more than 40 percent.

If it stands, the gainful employment regulation is likely to accelerate the increasing movement of for-profit institutions, particularly large national chains and online institutions, into offering bachelor’s and advanced degree programs that cater to students better able to repay federal student loans. Because longer programs entail more Title IV aid, for-profits already had a strong incentive to develop these programs. For-profits have more than quadrupled their share of bachelor’s degrees granted, from 1.6 percent in 1999–2000 to 6.7 percent in 2010–11. An analysis by J. P. Morgan that considers the impact of the gainful employment regulation on the sector repeatedly mentions “high exposure to bachelor’s degrees” as a positive factor for the stock price of publicly traded for-profits.

Looking Ahead
We draw three main conclusions from our overview of the for-profit sector and its role in educating disadvantaged students. First, although community colleges may provide an equal or better education at lower cost, demand for higher education is likely to outpace state funding in the near term, and many students who attend for-profits are not academically strong enough to attend a selective institution. Thus the relevant comparison of costs and benefits for individuals who attend a for-profit institution will often be no postsecondary credential at all. In this sense the gainful employment regulation, which attempts to estimate whether a program
provides good value to students who enroll, seems appropriate in principle.

Second, for-profit colleges seem to be at their best with short, well-defined programs that offer a clear path toward a particular occupation. Such programs are also potentially easier to regulate because their objective is clear. Expanding the reach of the gainful employment standard to apply, for example, to recipients of an associate’s degree in liberal arts at public community colleges would be more difficult to justify because personal exploration and the option value of future education are essential features of the program. In that case, low costs and low measurable benefits in terms of postgraduate earnings make more sense. In contrast, the student who graduates from a high-tuition for-profit college with substantial debt and who does not find steady employment at a reasonable wage will quickly encounter financial difficulties, and there is less of a case that such an education has the broad social benefits of liberal arts programs.

Finally, the relatively poor performance in terms of completion rates, default rates, and labor market outcomes of those attending for-profits among seekers of bachelor’s degrees is troubling because the sector seems to be heading in that direction. Large national chain for-profits have a relatively greater share of their enrollment in bachelor’s degree programs than other for-profits, and among all for-profits, the rate of growth in enrollments and degrees awarded in bachelor’s and advanced degree programs has been much greater than that for associate’s degree and certificate programs. Because tuition in bachelor’s degree programs is higher and students enroll for more years, the federal government’s per-student commitment of taxpayer money is several times greater than for a one-year certificate program. In principle, greater taxpayer commitment should be accompanied by increased scrutiny concerning whether students complete the program and make sufficiently high earnings to justify the investment and pay back their student loans. Yet much of the education production process in bachelor’s degree programs is a black box, even for (perhaps especially for) more selective four-year institutions. The set of skills one gains with a bachelor’s are varied, as are the set of potential occupations in which one can be employed. The variety of goals and outcomes presents a challenge for regulation.

When students vary greatly in their goals and projected benefits of education, a “one size fits all” regulation for a degree program becomes difficult to manage. One possible solution is to strengthen disclosure requirements.73 If potential students could view costs and expected benefits of a program in a simple and standardized format, they could make better decisions, and the government would not have to impose a uniform standard of value. Even better, requiring counseling by an independent third party to make sure prospective students understand financial aid packages and student loan obligations could mitigate the incentives faced by many recruiters at for-profits.

The for-profit sector plays, and is likely to continue to play, an important role in U.S. higher education in an era of public-sector fiscal constraints. A key challenge in regulating for-profit colleges is to restrain overly aggressive and potentially misleading recruitment practices while not stifling educational innovation and improved postsecondary learning opportunities for disadvantaged students.
Endnotes


2. Title IV eligibility allows institutions to administer federal student aid, primarily in the form of Pell Grants and Stafford Loans. The discussion and analysis in this paper excludes for-profit schools that are not Title IV eligible; little is known about these schools because the U.S. Department of Education does not track them. Virtually all degrees are granted by Title IV–eligible institutions, but programs that are less than two years in length that grant certificates (also diplomas) often are found at non–Title IV institutions. For an analysis of the importance of the non–Title IV group of for-profit schools using state registration data, see Stephanie R. Cellini and Claudia Goldin, “Does Federal Student Aid Raise Tuition? New Evidence on For-Profit Colleges,” Working Paper 17827 (Cambridge, Mass.: National Bureau of Economic Research, February 2012).

3. We define a “chain” as having campus branches in at least two census divisions or as being located primarily online. In constructing our definition of a “chain” for-profit, we follow David J. Deming, Claudia Goldin, and Lawrence F. Katz, “The For-Profit Postsecondary School Sector: Nimble Critters or Agile Predators?” Journal of Economic Perspectives 26, no. 1 (2012): 139–74, and combine “regional” and “national” chains into a single category. We classify institutions as “online” based on the institution’s name and the distribution of students across U.S. states.


5. Bennett, Lucchesi, and Vedder, “For Profit Higher Education” (see note 1).


9. Of the 5.265 million increase in fall enrollments in Title IV institutions from 2000 to 2009, for-profits accounted for 1.566 million, or 29.7 percent. Of the 1.318 million increase in degrees and certificates awarded by Title IV institutions from 2000–01 to 2009–10, for-profits accounted for 438,000, or 33.2 percent. See U.S. Department of Education, National Center for Education Statistics, Digest of Education Statistics, 2002, table 170; 2011, table 196.


13. Ibid.
14. National Center for Education Statistics, “2004/09 Beginning Postsecondary Students Longitudinal Study (BPS: 04/09),” NCES 2012-246 (U.S. Department of Education, 2011). Figures are weighted to be nationally representative of first-time, full-year undergraduates in fall 2003 in for-profits, community colleges, and nonelective four-year public and nonprofit institutions. Nonselective four-year institutions are defined by the BPS as either explicitly open admission or in the bottom 15 percent of median SAT/ACT scores and in the bottom 15 percent of the share of applicants denied admission.

15. For the definition of “selective” and “nonselective,” see table 1.

16. This definition of loan default in the BPS is different from the regulatory standard established by the U.S. Department of Education, which measures an institution’s “three-year cohort default rate” as the share of borrowers at each school who enter into repayment on federal loans during a twelve-month period and subsequently default in the next three years. Because a shorter window leads to lower counts, the official 2009 three-year cohort default rate among proprietary schools of 22.7 percent implies that for-profit students in the BPS data have lower default rates than the 2009 national average. That is likely due to some combination of worsening economic conditions and differences between the BPS sample and the overall population of students at for-profits.

17. Some students switch into different types of award programs (moving, say, from a certificate to an associate’s program) within the same institution during their first semester. In all of our results, we classify students by their initial self-reported plans to seek each type of award in the fall of 2003, rather than by the program in which they are enrolled at the end of the semester.

18. For further information, see tables 2 and 3 and appendix tables 2 through 5 in Deming, Goldin, and Katz, “The For-Profit Postsecondary School Sector?” (see note 3).


24. Data are from Deming, Goldin, and Katz, “The For-Profit Postsecondary School Sector” (see note 3).


28. Ibid.


31. Ibid.


44. For example, in many states, such as Texas, a sizable share of community college funding also comes from local property tax revenues, either at the county level or through the establishment of community college taxing districts. In Florida, on the other hand, all public funding of community colleges comes from a block grant provided by the state. See Donald C. Hudson, *A Policy Analysis of Community College Funding in Texas*, doctoral dissertation, University of Texas at Austin (2008); and David Moltz, “For Florida Community Colleges, Who Should Pay?” *Inside Higher Ed* (www.insidehighered.com/news/2008/09/19/florida).


46. Ibid.

48. The estimated costs to taxpayers depend on assumptions about defaults and recovery rates on federal student loans across sectors. The Apollo Group uses a default rate of 39.5 percent for the for-profit sector based on a weighted average of the Department of Education’s published lifetime default rates for two- and four-year institutions. They assume a loan recovery rate of 60.6 percent, which effectively reduces the cost of default by 60 percent. However, there is little data available on recovery rates. Cellini, “Crowded Colleges and College Crowd-Out” (see note 36) uses a recovery rate of 10 percent. If this rate were applied to the Apollo Group’s calculation, the cost to taxpayers would rise from $4,519 to $5,487 for for-profits and from $11,340 to $11,596 for public institutions.


50. Cellini and Chaudhary, “The Labor Market Returns to a Private Two-Year College Education” (see note 23); Deming, Goldin, and Katz, “The For-Profit Postsecondary School Sector” (see note 3); Lang and Weinstein, “Evaluating Student Outcomes at For-Profit Colleges” (see note 21); Turner, “Do Students Profit from For-Profit Education?” (see note 22).


53. Authors’ calculations based on the data from U.S. Department of Education, Federal Student Aid Data Center (http://federalstudentaid.ed.gov/datacenter/).


55. Cellini and Goldin, “Does Federal Student Aid Raise Tuition?” (see note 2).


58. In addition, an amendment to the Higher Education Act in 1998 lengthened the period of delinquency required to constitute a “default” from 180 to 270 days. This action lowered the default rate mechanically, although much of the drop in defaults happened in the mid-1990s, before this change.

59. U.S. Department of Education, Office of Inspector General, “Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs,” Final Audit Report (2003). This audit study of cohort default rate methodology found that trends in defaults looked different when a third year was added to the calculation. It also showed that deferments and forbearances rose from 5.2 percent of all borrowers in 1993 to 21.7 percent in 1999. Loans in deferment or forbearance over the life of the cohort default rate window are counted as “nondefaults.”
60. To compensate for this change, the threshold of a 25 percent default rate in three consecutive years was raised to 30 percent (but the one-year threshold of 40 percent remained the same).


62. Cellini, “Financial Aid and For-Profit Colleges” (see note 56).


64. Unlike the cohort default rate, in this calculation students with deferments and forbearances do not count as being “in repayment.” They must actually repay at least one dollar of their loans to qualify.


67. Programs with thirty or fewer students in the 2011 graduating cohort do not report repayment and debt-to-income data. Over time, the regulation will apply to programs with more than thirty graduates over a four-year time period.

68. Deming, Goldin, and Katz, “The For-Profit Postsecondary School Sector” (see note 3)

69. U.S. Department of Education, Federal Student Aid: 2011 Gainful Employment Informational Rates (http://federalstudentaid.ed.gov/datacenter/gainful2.html). These Department of Education data classify each program by its Classification of Instructional Program (CIP) code, and we separate programs by their major 2-digit CIP code program area.

70. Steinerman, Volshteyn, and McGarrett, “Education Services Data Book” (see note 39).


73. Bridget Terry Long, “Grading Higher Education: Giving Consumers the Information They Need” (Washington: Center for American Progress and the Hamilton Project, 2010). This paper discusses an approach to improving consumer information regarding higher education.