Feds Should Think Twice About Regulating For-Profit Colleges

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Business is booming at America's for-profit colleges. With steady high unemployment rates, many of the job-hungry have opted to pursue higher or specialized degrees in an effort to make themselves more marketable. Pricy for-profit institutions, like the 400,000 strong University of Phoenix, are flourishing with this increased demand as students flock to their courses to invest in new career prospects.

But recent regulatory activity at both the state and federal levels may signify that the party is over … or, more likely, that it must settle down quite a bit. Questionable recruiting and student financing practices at some career colleges have brought these education companies to the attention of many state attorneys general, the Department of Education, and the Senate Committee on Health, Education, Labor and Pensions, with the latter holding hearings on student financing at for-profit colleges.

Federal-level issues largely center on less-than-desirable statistics regarding federal student loans. Apparently, nearly half of federal student loan defaults come through these for-profit colleges, while financing for students at the institutions grows rapidly. Significant to these statistics is how expensive for-profit colleges are as compared to state schools. A 2010 GAO Report noted that, while enrollment in career colleges jumped from 1 million to 1.8 million students from 2003-2008, federal student aid to those institutions tripled from $8 billion to $24 billion.

State-level issues revolve around alleged violations of consumer protection statutes through aggressive recruiting tactics. For instance, for-profit colleges are being investigated for potential false or deceptive claims to prospective students on accreditation for degree programs and post-graduation career prospects. Also at issue are colleges' disclosures of student loan financing and loan default rates.

Some ten states' attorneys general formed a task force in March to combine efforts and share investigative information as they pursue actions against these institutions. States, including New York and California, are and have been going after for-profit colleges on their own (including a recent action by New York AG Schneiderman against Trump University).

At the federal level, the Department of Education has been busy establishing new regulations for career colleges. The most notable of late, the "gainful employment" rule, will require colleges to demonstrate that at least 35 percent of students are repaying their loans, or that loan repayments do not exceed 30 percent of their discretionary income or 12 percent of their total earnings. Schools failing to meet the standard in three out of four years will no longer be able to accept student payment with federal loans.

These government efforts may make it seem that career colleges are nothing more than greedy institutions preying upon the unemployed during bad economic times, and that the white hat-donning government regulators are nobly reining them in.

However the economics of, or the basis of, for-profit colleges does not appear to have been considered: for-profit colleges are not as much in the business of educating and graduating stellar students as they are in the business of making money. These companies have an interest – and obligation to their shareholders/investors – to maximize profit and minimize cost. The more money they can charge students and the less money they must dole out for the service they provide (i.e. education), the better off they are. And again, that is their overarching duty to their investors.

In a perfect free market, career colleges could not charge exorbitant fees to attend their schools if their students could not get jobs after graduation – because students would not pay. But in our current structure where the cash cow of federal student loans exists, both for-profit colleges and prospective students have almost unlimited access to big funds. For-profit colleges would be irresponsible to their investors if they did not tap this resource. Students often are not responsible enough to understand the consequences of accruing significant student loan debt.

Bottom line, much of the issue of for-profit colleges in the social context is that they have both a financial and legal duty to act in their own interest. The problems federal and state regulators seek to address are largely problems created by the federal government's presence in the first place. Without the federal cash cow, private lenders (who would be the sole source of student financing) would insist both for-profit colleges and students behave differently. Colleges would have to improve performance and students would have to be more judicious about how they spend their money.

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