

THE CENTURY FOUNDATION

Issue Brief

KEEPING THE SPOTLIGHT ON STUDENT LOANS

BY GORDON A. MACINNES

With the signing of the budget reconciliation bill on March 30, the federal student loan program basked briefly in its reflected glory. Student loans were the sidekick of health care reform. Reconciliation ends the nonsensical practice of subsidizing banks to originate loans that are almost fully guaranteed by the federal government. By this July, all student loans will be issued directly by the government. The \$6 billion in annual savings will be used to increase Pell Grants, assist historically black and community colleges, and ease re-payments by borrowers in public service or other lower-paid jobs.

As helpful as these changes are for students receiving Pell Grants or the borrowers able to stretch out their repayments, the world will seem little changed for most borrowers. Interest rates remain, for example, at their comparatively high rate of 6.8 percent.

As overdue and sensible as the switch to direct lending is, it leaves untouched major problems that each year further impoverish tens of thousands of Americans. The banks were the first and easiest target for reforming student loan policies and practices. The federal government needs to finish the job by ensuring that student loan policy helps the intended beneficiaries—poor and middle-class students who otherwise could not afford college—instead of protecting the for-profit higher education industry that federally guaranteed student loans helped create and has sustained. (In a second commentary I will take a look at the business side of the for-profit educational industry, which has used taxpayer funds to create at least two billionaires.)

A PERSISTENT PROBLEM: STUDENTS WHO DEFAULT, AND THE SCHOOLS THAT THEY ATTENDED

Borrowers who default on their student loans are a telling indicator of their schools or colleges. As it happens, former students of for-profit schools are over twice as likely to end up in default than their peers from public and non-profit colleges. There are a lot of reasons that student borrowers might default, but here are the most common-sense reasons that might apply to students attending for-profit schools:

- because for-profit schools have higher costs, students have to borrow more;
- because the students lack family financial support, they have to borrow more;
- institutional grants are unavailable or, if they are available, they cover a lower portion of all costs;
- the education received does not prepare students to obtain jobs that make repayment affordable; and/or
- more students drop out before attaining the degree or certificate they sought.

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A telling statistic is that only about 8 percent of all students attend for-profit or “proprietary” postsecondary institutions, but they command about 25 percent of federal loan funds and are responsible for about 40 percent of defaulted loans. Disproportions of this magnitude have been true for decades, but have been overlooked by federal officials and legislators to the benefit of for-profit operators. There are many reasons why allowing for-profit, proprietary schools to thrive on a river of federal funds is a poor idea, but five in particular stand out.

1. Practically all for-profit institutions are more costly than public or even nonprofit colleges and universities. And, it’s not a close call.

Applicants seeking an associate degree from a two-year institution will start with costs that are over *three times higher* at a proprietary college compared to the public community college (\$22,536 versus \$6,717 in 2008). Public four-year institutions are about half as expensive as their for-profit competitors (\$12,944 versus \$24,511—and these numbers include room and board that are not offered by most, if any, proprietary colleges). Even with the recent steady climb in public college tuition rates, they represent an obvious bargain. For students from poor families, a Pell Grant will cover a large share of the community college tuition, while those at proprietary schools must rely overwhelmingly on loans.

2. For-profit colleges have no revenue without federal loans and grants, so practically every student borrows . . . and borrows.

In the 2003–04 academic year, 86 percent of students in proprietary colleges carried a Stafford loan, compared to just 24 percent of students in community colleges. A recent College Board [study](#) found that while just 5 percent of community college students finish school with more than \$30,000 in debt, virtually all (98 percent) of for-profit community college graduates carry student loan debt, and of those, 19 percent carry debt in excess of \$30,000. The numbers for graduates with bachelor degrees are more terrifying: virtually all (96 percent) bachelor degree recipients from for-profit schools carry debt, and of those, 60 percent start with debt of more than \$30,000 (one-quarter of all their graduates owe more than \$40,000); by comparison, only 62 percent of graduates from public universities have debt, and only 20 percent of those have debt over \$30,000.

The story gets worse. While virtually every graduate of a proprietary college leaves with federal loan debt, 60 percent of those with associate degrees and 64 percent of those with bachelor degrees also carry private loans. The numbers for community colleges and public universities are 15 percent and 28 percent, respectively. Private loans are not regulated, have much higher interest rates (up to 20 percent), usually have less lenient repayment schedules, and cannot be discharged in bankruptcy. No wonder banks love them.

A final note from the College Board study: the level of debt is growing much more rapidly among proprietary college graduates, rising more than 23 percent in the four years, 2004 to 2008, for those seeking bachelor degrees.

3. Students at for-profit schools are about 50 percent more likely to receive a Pell Grant than are students in community colleges.

The frequent response of the “career college” community to criticisms about its high loan default and dropout rates is that it is enrolling students from very poor backgrounds. About half of their students qualify for Pell Grants compared to a third of community college students. While this argument is not without merit, it overlooks the fact that the business plan of practically every proprietary school is based on attracting those students who bring the heaviest federal subsidies.

4. Despite their growing profitability, proprietary schools do not offer significant scholarship funding, if any.

The University of Phoenix—the dominant subsidiary of the Apollo Group—is the most sophisticated, best-known, largest, and most profitable university in the for-profit college world. In its 2009 annual report, it boasts of providing scholarship assistance to 433 of its 400,000+ students. Bragging about giving a paltry 0.1 percent of the student body some financial assistance may be unsurprising in the world of commerce and advertising. But even this drop-in-the-ocean commitment has not been taken up by many of its competitors.

If most proprietary colleges avoid scholarships, a growing number are happy to get into the private loan business as it is abandoned by Sallie Mae and other large lenders. Private loans are to student loans what subprime mortgages are to the housing market. As a part of the frantic borrowing binge, Sallie and others wrote hundreds of millions of dollars worth of private loans—despite default rates as high as 70 percent—as a lever to be named a “preferred” lender for all loans. As its loss reserves multiplied, Sallie Mae announced its exit from the risky business. Proprietary schools are stepping in because private loans are the “loss leaders” to the federal treasure chest of guaranteed loans and grants. (There is a ceiling on federally-guaranteed loans that means that the higher costs at for-profit and nonprofit colleges more frequently calls for private loans.)

5. Even with higher costs, greater debt, and strong promises of success, most students do not graduate from proprietary schools.

About the same percentage of community college students and for-profit, two-year college students emerge with either a bachelor or associate degree after six years (26.7 percent versus 27.8 percent, respectively). However, for-profit students are much more likely to emerge with a certificate (27.8 percent versus 10.1 percent). The performance of students at four-year institutions is dramatically different, with 53.3 percent of public university students attaining a bachelor’s degree after six years, against only 20 percent in proprietary institutions. The poor completion rates at proprietary four-year institutions are particularly troubling. Since a degree or certificate is usually required by employers, those who do not complete their coursework are at a huge disadvantage to find employment that will permit them to repay their student loans. High default rates and low graduation rates go hand-in-hand and proprietary schools lead in both categories.

WHAT SHOULD BE REQUIRED

When it comes to proprietary for-profit colleges, the federal government has failed to guarantee applicants the readily available information they need to make a prudent decision about postsecondary education and how to pay its costs.

High schools, rather easily, can track their graduates to report on what percentage enrolled in college and, even, what percentage completed their degree within six years. Nonprofit business schools routinely report what percentage of their graduates was employed by what sector at what average starting salary. State corrections can report on the number of prisoners released on parole and the number of parolees re-jailed.

With transparency such a simple task, is it not possible for the federal government to require “career colleges” and schools to report on their graduation rates, the employment rates of their graduates, their average starting salary, the average debt carried at graduation and the default rate for its graduates? Practically none of this information is available on the website of any proprietary school or college! Schools with low graduation and job placement rates and with high default rates should be expelled from the Pell Grant and guaranteed loan program.

Under current law, the same United States Department of Education that will not take action against failed proprietary schools that receive more than 90 percent of their revenues from the federal government will happily label an elementary school where 20 percent of special education students were not proficient on a state test a failed school. And, it only pays 8 percent of the bill! The fact that the reputation of proprietary trade schools has gone from “criminal” in the 1990s to merely “scandalous” today is no reason to defer strong action.

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