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Report on Gainful Employment: Executive Summary

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This report addresses the definition of "gainful employment" proposed by the U.S. Department of Education as a part of negotiated rulemaking.

CONSEQUENCES/IMPACT OF THE PROPOSED GAINFUL EMPLOYMENT REGULATION

To estimate the impact of the proposed regulation on Title IV eligible for-profit postsecondary institutions, we collected data from Career College Association (CCA) member institutions. We analyzed data representing approximately 640,000 students and over 10,000 separate programs from institutions ranging from very small to very large. Using these data, we compared the median debt among a program's graduates to the maximum allowed loan implied by the 8-percent rule applied to the appropriate 25th percentile of earnings, calculated according to the Department of Education's instructions.

Based on these calculations, we estimate that 18 percent of for-profit postsecondary programs would not satisfy the debt limit requirement of the gainful employment proposal. In our calculations, larger programs will be more likely to be impacted. Consequently, we estimate that 33 percent of students in for-profit postsecondary programs would be impacted. Applying these findings to for-profit enrollment reported in IPEDS, we estimate that approximately 360,000 students each year enter for-profit postsecondary programs that would lose eligibility for participation in the federal Title IV financial aid programs. Given recent growth rates of enrollment in for-profit postsecondary institutions, we estimate that by 2020, approximately 5.4 million students who are on track to attend programs would be denied access by the proposed regulation. Our estimate is that the impact of the regulation would be severe on racial and ethnic minority groups, in part because for-profit schools are proportionately more likely than not for-profit postsecondary schools to serve these students. We estimate that each year approximately 68,000 non-Hispanic black students and an additional 79,000 Hispanic students enter for-profit postsecondary schooling in programs that would be impacted by the proposed regulation and would not be able to attend these programs. While some capacity may exist in other sectors of higher education to absorb these students, recent reports indicate that the most likely alternatives—community colleges—are already oversubscribed in many cases, and are facing further financial cutbacks as the states that provide much of their funding face severe financial challenges. Given recent growth rates at for-profit postsecondary institutions, we estimate that by 2020 approximately 1 million non-Hispanic black students and an additional 1 million Hispanic students are on track to attend programs that would be adversely affected, and would be denied access as a result.

Based on our estimates, the impact of the regulation would vary across types of programs. Because the limits on borrowing do not vary with the length of program, longer programs would be more severely impacted. Whereas approximately 18 percent of students in less than 2 year programs would be impacted, we estimate that approximately 40 percent of students in 2- and 4-year programs would be impacted. We also estimate that the impact would not be limited to a few areas of study, but would impact a wide variety of programs. For example, we estimate that nearly 14 percent of Health Professional and Related Clinical

Sciences, including Nursing, programs and more than 46 percent of Engineering Related Technologies/Technicians programs would not currently satisfy the proposed debt limit rule.

A SOLUTION IN SEARCH OF A PROBLEM

We are unaware of any, scientific or otherwise, study by the Department of Education that outlines what the problem is that the proposed regulation is meant to address. The problem that the regulation aims to solve has not been clearly stated – neither its nature nor its extent. As a result, we believe, the proposed regulation is not well-designed to address a specific problem.

Any regulation aimed at solving a specific problem should be tailored to address that problem without causing undue harm to other individuals. Based on a few anecdotal references to complaints of high debt levels by students, posted in the public comments to Negotiated Rulemaking on the Department's website, we suspect that the Department of Education aims to protect some students who take on more debt than they can expect to repay. We also suspect that the number of students who take on more debt than is in their personal interest is small, but we are not aware of a study of this population that would inform this speculation. A regulation aimed at protecting these students should focus on identifying these students and should address these students directly. Because the proposed regulation applies to schools rather than students, it would affect students who are not over-borrowing along with any who may be over-borrowing.

Are Default Rates Higher at For-Profit Colleges?

One stated rationale for the proposed regulation is that default rates are higher among students at for-profit postsecondary schools than among those at not-for-profit colleges. Our analysis of the Beginning Postsecondary Students Survey data shows that at least half of the difference in default rates between for-profit and not-for-profit schools is because they serve different types of students. For-profit schools are more likely to serve low-income students, racial and ethnic minority students, students who are the first in their immediate family to attend postsecondary schooling, and students whose families have collected public assistance. Students in these groups are more likely to default on student loans after attending both for-profit and not-for-profit colleges.

We estimate that if all schools served students with moderate family resources, loan default rates at for-profit schools would be cut by more than half and the difference in default rates between for-profit and not-for-profit schools would also be cut approximately in half. These estimates are based on regression-based controls for students' family income, dependent status, race/ethnicity, program completion status, parental education, family welfare receipt, and Pell eligibility. It is possible that controlling for additional student characteristics, if data were available, would reduce the default rate gaps even more.

RATIONALE FOR THE METRICS OF THE REGULATION

The debt limit portion of the proposed Gainful Employment regulation focuses on the ability of recent graduates to repay loans in the early years of their post-schooling careers. The choice of metrics to assure students' ability to pay is logically flawed. Furthermore, the basis of the debt limit on earnings early in the career stands in contrast with standard economic analysis of education, which clearly says that the choice of how much to borrow for schooling should be based on the benefits of schooling, and not on the earnings level at the beginning of a career. Any proposal aimed at helping students make smart decisions about investments in education should compare the costs of schooling to the *gains* that accrue over the full career as a result of that schooling. It should not compare costs to the *level* of earnings of recent graduates.

The 8 Percent Debt Limit

Consider the 8 percent limit on debt payments. First, no scientific or data-driven rationale has been presented for an 8 percent limit as opposed to any other number. No evidence has been presented, for example, that loan default rates increase dramatically as student loan payments cross this threshold. And though no specific rationale has been given for the 8 percent number, to the extent that it is based on rules of thumb from other types of borrowing, such logic would also be flawed. Borrowing for the purpose of education is inherently different from borrowing to purchase a home because the economic returns tend to be much larger. Education is a source of social mobility, so any restriction on student borrowing will tend to be harmful to students who would have enjoyed large gains from the schooling investment.

Second, it cannot logically make sense to say that the average student cannot afford to pay 8 percent of her annual earnings to cover student loans for 10 years if those loans paid for education that raised her earnings more than 8 percent each year for the rest of her working life. Academic studies consistently find that students with more education on average earn more, and that these returns to education are large on average, for example, in 2-year Associate degree programs. Academic estimates of the return to education – the increase in annual earnings that result from each additional year of schooling – have ranged from 8 to 15 percent, and have been rising steadily over the past 30 years. Our best estimate is that the return per year of Associate degree schooling is currently more than 10 percent. This means that those who earn a 2-year degree earn between 20 and 25 percent more each year than those with just a high school education. If the average return to a year of schooling is 10 percent, this means that the average student in a 2-year program could pay 8 percent of her earnings just with the additional earnings due to the schooling, even after accounting for taxes.

These average benefits also do not include additional economic benefits of schooling. Additional benefits of education include increased employment rates, increased likelihood of health insurance coverage, decreased criminality and improved health.

25th Percentile of Earnings

Many features of the proposed regulation share the flaw that limits on borrowing are based on the estimated earnings that graduates would experience in the early years after graduation. This is a flaw because the benefits of education accrue over a long period of time. A policy aimed at protecting students would compare the benefits of education and the costs of education. A key feature of education is that the costs are paid up front, both in terms of foregone earnings and tuition, and the benefits accrue over the entire working life. To focus exclusively on the short-term benefits is to ignore the long-term benefits and to cause students to under-invest in education. This under-investment would likely be harmful to many students affected by the proposed regulation.

One example is the use of the 25th percentile of earnings as an implied ability to repay loans. The proposed regulation places a limit on the median debt among students at a program. This limit is based on the 25th percentile of earnings in occupations for which that program prepares students. Presumably, the 25th percentile is meant to be an estimate of the typical starting salary of graduates of the program. The use of the 25th percentile is flawed for multiple reasons. Most fundamentally, the premise of limiting borrowing for education based on early-career earnings is inappropriate and would be harmful to low-income students who rely on student loans for access to education beyond high school.

In addition, the choice of the 25th percentile appears to be *ad hoc*, possibly based on the fact that it is one of the statistics that the Bureau of Labor Statistics publishes for each occupation. However, there is no scientific basis for using the 25th percentile of earnings as an estimate of the early career experience of workers rather than some other percentile (and we reiterate that limits should not be based on the level of earnings of early career workers in the first place, but rather an estimate of the individual gains to earnings that result from the education). Other percentiles could be calculated fairly easily based on the same data used by the Bureau of Labor Statistics.

Furthermore, the particular way to calculate the 25th percentile is not innocuous. Small changes in the way one calculates this number causes large differences in the estimate of early career earnings. One concern would be that future changes in the method of calculating this number could have serious consequences. We estimate that differences in earnings levels resulting from changes in how the 25th percentile is calculated would lead to large differences in the number of students impacted by the proposed regulation. This suggests that further consideration should be given to: (a) whether the 25th percentile concept is appropriate, and (b) whether the method of calculating the student's estimated ability to pay is overly sensitive to small changes in the future and valid from a scientific standpoint.

10-year Repayment

The proposed regulation indicates that annual loan payments should be based on a 10-year repayment period. The use of the 10-year repayment length is another way that the

regulation would overweight the early costs of education and ignore the future benefits. As mentioned above, the benefits of additional schooling accrue for the entire working career, which for most students lasts significantly longer than 10 years, in many cases three times as long. By calculating loan payments using a 10-year repayment, the regulation in a sense imposes a decision rule on students that weights the costs of schooling two- to three-times as much as the total benefits of schooling. Overweighting of costs in this way would be shortsighted if it were done by students making education decisions. Any regulation that imposes such a decision rule on students would cause many students who would otherwise benefit from additional education to be harmed.

Further Analysis of the Methodology Used to Compute the Metrics of the Regulation

The proposed regulation is based on a formula that has many moving parts. For each piece of the debt limit formula, decisions must be made that determine the precise way the value will be calculated. These decisions are not all straightforward, can have large effects on the impact of the regulation, and have not to our knowledge been based on scientific research or subject to sensitivity analyses. One prominent example is the method used to calculate the 25th percentile of earnings. While such a statistic sounds straightforward, it is not. Most areas of study prepare students for multiple occupations, as defined by the Bureau of Labor Statistics. There is not a singular method for calculating the 25th percentile of earnings among workers entering multiple occupations. The method proposed by the Department of Education during Negotiated Rulemaking indicates that a weighted average of 25th percentiles within each of the occupations should be used. Taking a weighted average of 25th percentiles within occupations does not, however, give the 25th percentile of earnings among the workers in those occupations. Take, for example, the case of Business, Management and Marketing. One of the occupations for which that area of study prepares students, according to the Department of Education, is Chief Executive. Thus, the Department of Education's method bases the early career earnings of students finishing business management degrees in part on the 25th percentile of earnings of chief executives. We suspect that a recent college graduate has a vanishingly small chance of earning a chief executive salary in the first few years after finishing school, though some will become chief executives later in their careers.

Assuming the Department's goal is to generate an estimate of the early earnings of a program's graduates, there are some types of occupations for which taking the weighted average of percentiles may make sense, and others for which it does not. Even when a weighted average may be appropriate, how to weight is an important question that must be addressed. There is not a simple solution to the general problem of how to estimate the future earnings of a program's graduates, and more thought and study should be given to how to address it. One risk that should be addressed is that future decisions about which occupations for which a program prepares students could have very large effects on the resulting borrowing limits for that program. Since these decisions may be made for other

reasons, or capriciously, the regulation would be at risk of having unintended consequences based on future seemingly unrelated decisions.

There has also been no guidance as to what defines a program for the purpose of the proposed regulation. For our analyses, we define a program as an area of study (i.e. a CIP code), at a particular location or campus, for a specific program length (i.e. less than 2-year, 2-year, or 4-year). An alternative would be to define a program based on an institution's OPEID code rather than a campus. Doing so could create unintended incentives to combine campuses into OPEID codes. This is another indication that the proposed regulation's implementation at the school or institution level, rather than at the student level, is problematic.

CONCLUSION

In summary, the proposed regulation is not currently formulated to address a specific problem effectively. Secretary of Education Arne Duncan has stated publicly that he wants to ensure that the Department understands its proposal thoroughly so that it prevents any ―unintended consequences." Our analysis suggests that the ―unintended consequences"—cutting off access to hundreds of thousands of students who want postsecondary education—will be much more substantial than the intended consequence, which we believe to be—though we are not certain—reducing the number of students who over borrow.

To start, the Department of Education has not clearly defined what the problem is that the regulation aims to address. As discussed above, some perceived problems the regulation may intend to address are not problems at all but rather a reflection of the fact that for-profit postsecondary schools serve a very different population than not-for-profit postsecondary schools. If the Department of Education wishes to address the problem that some students take on excessive debt, the proposed regulation is not well designed to do so. By applying a rule at the school or program level, many other students would be negatively affected. Our analysis suggests that 33 percent of students currently in for-profit postsecondary schooling would be denied access. Many more students would be denied access to postsecondary schooling than would be protected from excessive borrowing.

Furthermore, it should not be assumed that public postsecondary institutions, particularly community colleges, would absorb these students. Given the fiscal conditions of the states, it is not obvious that community colleges will be able to increase capacity to meet the increasing demand for postsecondary schooling.

Finally, because for-profit schools disproportionately serve racial and ethnic minority students and students from low-income family backgrounds, the regulation would have the effect of reducing access to higher education to groups of students that have historically had the lowest levels of access.