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MONEY, POLITICS AND THE RISE OF FOR-PROFIT HIGHER EDUCATION IN THE US: A Story of Supply, Demand and the Brazilian Effect

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**MONEY, POLITICS AND THE RISE OF FOR-PROFIT HIGHER EDUCATION IN THE US:  
A Story of Supply, Demand and the Brazilian Effect\***

February 2012

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UC Berkeley

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**ABSTRACT**

For-profit colleges and universities in the US have been growing at a staggering pace in enrollment, in profits, and in the corporate value of those traded on the New York Stock Exchange. From 2000 to 2010, the sector grew by some 235 percent in enrollment, increasing its market share from 3 to 9.1 percent of all tertiary enrolled students. What accounts for this rapid growth in the For-Profit (FP) sector in the US? How will such growth influence educational opportunity and degree attainment rates in a country that first pioneered a mass higher education built largely around expanding public colleges and universities? As discussed in the following essay, there are specific characteristics of the FP sector that are peculiar to the US; others reflect global trends largely seen in developing economies. Simply put, in the US as in other parts of the world, the FP sector is a modern feature of changing market dynamics related to demand and supply – or the lack thereof. As discussed in this essay, the current US experience is a version of what I call the “Brazilian Effect”: when public higher education cannot keep pace with growing public demand for access and programs, governments often allow FP’s to rush in and help fill the gap, becoming a much larger and sometimes dominant provider. This is the pattern in many developing economies such as Brazil where some 50 percent of student enrollment is in profit-like private institutions also found in Korea, Poland and many other parts of the world. Despite concerns about the economic model of For-Profits which rely heavily on taxpayer funds, their low degree completion rates, the quality of those degrees, their high tuition and fee levels, the high levels of debt and poor employment record of graduates, and new federal regulations and a series of lawsuits, my prediction is that the FP sector will continue to grow over the long-term not so much because it meets societal demands for diverse forms of higher education, but because of the inability of the public sector to return to the levels of public subsidies and program growth they had in the past – the Brazilian Effect. The result now, and in the future, is a kind of policy default: the future tertiary market will *not* be the result of a well thought out policy at the national or state levels, but a quasi-free market result that will foster lower quality providers and fail to meet national goals for increasing the educational attainment level of Americans. As this paper discusses, higher education policy is about broad issues of socioeconomic mobility and economic competitiveness, but it is also about money, big business, and political influence.

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In the midst of the Great Recession, for-profit colleges and universities in the US grew at a staggering pace in enrollment, in profits, and in the corporate value of those traded on the New York Stock Exchange. The eleventh largest for-profit higher-education companies, for instance, experienced an increase in their enrollments of over 30 percent between 2008 and 2010. These are teaching-only institutions, geared toward providing credential and degree programs in which they can make a good profit. The downturn in the economy triggered “hypergrowth” for for-profit institutions (henceforth FP), including a rush of laid-off workers seeking job retraining in largely vocational or professional fields (Marklein, 2011).

Before the recent bubble, steady growth in American FP’s was already a well-worn pattern over the last decade. From 2000 to 2010, the sector grew by some 235 percent in enrollment, increasing its market share from 3 to 9.1 percent of all tertiary enrolled students. At the same time, and not surprisingly, the number of new for-profit institutions grew. In the five-year period beginning in 2005, a total of 483 new colleges and universities gained regional or national accreditation in the US. Of those new institutions,

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some 77 percent were FPs, compared to only 4 percent public and 19 percent as independent nonprofit institutions. In total, and while still less than 10 percent of all enrollments, the FP sector currently accounts for 26.2 percent of all the postsecondary institutions in the US (Zhao, 2011).

What accounts for this rapid growth in the FP sector in the US? How will such growth influence educational opportunity and degree attainment rates in a country that first pioneered a mass higher education built largely around expanding public colleges and universities? As discussed in the following essay, there are specific characteristics of the FP sector that are peculiar to the US; others reflect global trends largely seen in developing economies. Simply put, in the US as in other parts of the world, the FP sector is a modern feature of changing market dynamics related to demand and supply – or the lack thereof.

As discussed in this essay, the current US experience is a version of what I call the “Brazilian Effect”: when public higher education cannot keep pace with growing public demand for access and programs, governments often allow FP’s to rush in and help fill the gap, becoming a much larger and sometimes dominant provider. This is the pattern in many developing economies such as Brazil where some 50 percent of student enrollment is in profit-driven private institutions and in Korea, Poland and many other parts of the world.

The American case is a different twist in this common theme. For example, Brazil began with an elite university sector and is trying to build a mass higher education system. The growth in private higher education includes FP’s, but also a mix of private non-profits. In the US, a once robust mass higher education system is in various stages of decline, exacerbated by the onset of the Great Recession.

Another difference with much of the world is the decentralized nature of America’s higher education system. State governments have jurisdiction over the size and shape of their public and private higher education sectors, and are the primary funder of public higher education. Throughout the US, states have been making massive cuts to their public higher education systems and to an array of social services. The decline in funding higher education is a trend long in the making, accelerating mightily over the past three years. In the mega-state of California - the largest state in terms of population and with an economy that would rank among the world’s top ten in size if it were a country – budget cuts are greatly diminishing the ability of public colleges and universities to hire faculty and provide courses to meet enrollment demand. There are similar examples of retrenchment in public higher education in about half of the fifty states.

The question is how this story will unfold over the next decade in the US? Under the creed that a variety of providers create more avenues for socio-economic mobility, America needs a robust FP sector as part of any coherent effort to increase educational attainment rates, improve the nation’s labor pool, and help create a more competitive economy. But there are indicators that an era of unquestioned and largely unregulated growth of the FP sector may be ending. There are new concerns at the national and state level about the economic model of FPs, their low degree completion rates, the quality of those degrees, their high tuition and fee levels, and the high levels of debt and poor employment record of graduates.

Despite these new concerns that are spawning new federal regulations and a series of lawsuits, my prediction is that the FP sector will continue to grow over the long-term not so much because they meet societal demands for diverse forms of higher education, but because of the inability of the public sector to return to the levels of public subsidies and program growth they had in the past – the Brazilian Effect.

The result now, and in the future, is a kind of policy default: the future tertiary market will *not* be the result of a well thought out policy at the national or state levels, but a quasi-free market result that will foster lower quality providers and fail to meet national goals for increasing the educational attainment level of Americans. As the following discusses, higher education policy is about broad issues of socioeconomic mobility and economic competitiveness, but it is also about money, big business, and political influence. And to a degree perhaps unmatched by other Western economies, in the United States money and lobbying are huge factors in determining government policies related to the funding and regulation of the FP sector.

### **A Diversity of Providers**

The for-profit higher education sector has long had a presence in the US, stretching back to the mid-1800s but with the first significant growth in the 1920s. In the post-World War I era, and with increased notions of professionalism as a means toward greater economic efficiency, new FP’s arrived teaching various forms of “business education,” that included secretarial and accounting courses. The decentralized nature of American higher education, in which states have the most significant authority to regulate the higher education market, and in which public and private higher education are both significant providers, has allowed for varying FP enterprises to thrive – legitimate and good quality institutions, along with those of low quality that became known as “diploma mills” – offering a degree for nothing more than a price.

Particularly after World War II, the FP sector in the US grew both in the number of institutions and in enrollment, benefiting from the large influx of returning veterans. The GI Bill offered generous grants for them to attend a college or university of their choosing. Beginning in 1944, returning veterans received \$500 a year for educational costs and a \$50 a month living stipend to attend a university, college, or a postsecondary vocational school. For some seven years, the GI Bill not only supported veterans attending the nation's network of public and nonprofit colleges and universities, it also fed the FP sector that included legitimate and largely vocationally oriented programs, but also a growing bevy of fraudulent enterprises that gained access to federal tax support through unsuspecting students.

Complaints began to make their way to Washington. Between 1950 and 1952, the Veterans Administration (or VA), the federal General Accountability Office (or GAO), the Bureau of the Budget, and two special committees appointed by the US House of Representatives, investigated what was perceived as widespread "incidents of fraud and abuse by for-profit" colleges and schools (Smole and Loane, 2008).

Consequently in 1952, the US government looked to accrediting associations – self-regulated and voluntary associations of public and private higher education institutions based originally around geographic regions – to help decipher who were legitimate providers versus exploitive operations.

### **Ensuring a More Friendly Market**

By the 1960s, the regional accreditation process, plus marginal efforts by some states to regulate the FP sector, placed some limitations on the FP sector, which evolved into two different economic funding models: accredited institutions that derived profits from students who had access to an evolving and growing federal and state program of grants and loans; and non-accredited institutions that relied on students to pay for tuition and fees. In both cases, as today, the FP sector almost exclusively focused on degree and credential programs in which there is relatively high demand and relatively low costs – the "low hanging fruit" that includes fields such as business, some technical fields including computer graphics, and professional support fields related to medicine and dentistry.

Three factors have significantly changed the market for the FP sector in the US over approximately the last two decades.

- First, ***the rising demand for higher education*** has been fueled both by population growth in the US and by the changing labor markets. College degrees and various forms of postsecondary credentials have increased in their value for the individual, and increasingly determine life-long income.
- Second, ***the influence of the Internet, changing technologies and new models for the "delivery" of education*** that allowed for less expensive forms of teaching and learning, and degree granting, than the traditional classroom model. The Internet has significantly expanded the marketing potential for FPs and helped reshape consumer ideas on what constitutes a college or university experience.
- And third, ***a much more favorable federal regulatory environment*** emerged during the presidential administration of George W. Bush. The Bush administration and a Republican controlled Congress favored market "solutions" for most domestic problems facing the nation, and this included changes in federal policy that, in effect, further opened taxpayers funds to the FP sector.

All of these factors helped to rebuild an industry that at one time was largely made up of sole proprietor institutions, some legitimate, some marginal operators, and some purely diploma mills. In the 1990s, a number of FPs emerged as the first major corporations in the sector traded on the American stock exchange – including the largest current FP, the Apollo Group which operates the University of Phoenix and has operations in the US (largely on the West Coast) and internationally.

George Bush's arrival in the presidency in 2000 and Republican control of both the House of Representatives and the Senate helped to significantly advance the interests of the FP sector. For FPs that had accreditation, and therefore access to students with federal financial aid, a federal law limited them to having no more than 50 percent of their total student enrollment in online enrollment – where they found the least cost and highest profits. If they went over the 50 percent rule, all of their students might lose access to federal aid to pay their tuition, which was generally higher than tuition in public colleges and universities for similar programs. This 50 percent limit was set in the early 1990s as a protection for consumers and was one of several measures intended to hinder diploma mills and address scandals related to the FP sector.

At the same time, the regional and national accreditation agencies posed problems for market growth. For unaccredited FPs, many complained about the regional accrediting bodies; they were controlled by traditional public and private higher education institutions (henceforth HEIs) and set standards that were unnecessarily high and that were biased against online providers.

Two bills and a series of actions by the US Department of Education, led by Bush appointees, changed the landscape for the FP sector. In 2005, and as part of the reauthorization of the Higher Education Act, the law limiting the amount of income FP's derived from federal taxpayers was revised. The original 1990 law stated that no more than 85 percent of the total tuition and fees derived from student grants and loans could come from federal financial aid programs, and specifically what are called Title IV funds. (Title IV refers to a stipulation in the Higher Education Act first passed in 1966 and re-authorized every ten years that includes most federal grant and loan programs for students.) The new legislation raised the limit back to 90 percent - the so-called 90/10 rule (Skinner, 2005). Purposefully exempted from this rule were financial aid funds for veterans - a lucrative market for FP's and a story we will return to.

A year later, Congress passed a bill that eliminated the 50 percent rule that limited the proportion of enrolled students who could be in online only courses. The legislation was co-authored by the chair of the House Education and Workforce Committee, John Boehner (Republican-Ohio and current Speaker of the House) and Senator Mike Enzi (Republican-Wyoming). Opposed by the American Council for Education and the American Association of Universities (both voluntary associations of public and non-profit HEI's), this policy shift signaled a dramatic opening for the FP sector. The result was the establishment of a large number of new, largely online FP institutions, enrollment growth in more established FPs, and a rush to gain capital for expansion largely through the stock market (Kinser, 2006).

During this same period, the US Department of Education launched a broad review of the federal role in America's higher education system. Among the proponents of this review was the assistant secretary for post-secondary education, Sally Stroup. Prior to joining the Bush administration, Stroup had been a lobbyist for the Apollo Group. She worked with the Secretary of Education Margaret Spellings to convene a Commission on the "Future of Higher Education" modeled on a famous 1983 federal review of the nation's schools alarmingly entitled "A Nation at Risk" (National Commission on Excellence in Education, 1983).

Convened in 2005, the "Spelling Commission" was charged to reshape American higher education for "the 21st century workplace." Reflecting Spelling's role and experience in developing the "No Child Left Behind Act" in 2001, the commission focused largely on a desire to develop standardized tests to determine learning outcomes at the tertiary level. The commission also promised to revisit the federal role in the accreditation process, address concerns regarding rising tuition costs, and voiced openly the desire to promote the FP sector.

For Bush administration officials, accreditation was a key lever for greater federal control of the higher education market place and for re-shaping public and nonprofit private HEIs. The US Department of Education was the agency that officially recognized regional and national accrediting bodies, some of which, such as the Western Association of Schools and Colleges (WASC), dated back to the 1880s. In the post-World War II period, the US Secretary of Education gained the authority to approve self-governing regional and national accrediting bodies. In turn, accreditation allowed a college or university to gain access to students with federal financial aid to spend. By the 1960s, accreditation was also a prerequisite for colleges and universities to gain access to other forms of federal funding, including research grants and monies intended to bolster access and equity (under Title IV of the federal Higher Education Act).

As stated by Charles Miller, the chair of the Spellings Commission and a Bush compatriot from Texas, "Accreditation is the primary barrier to innovation in American higher education . . . the biggest barrier to real competition. Accreditation is the biggest barrier to real change" (Lederman, 2007). With Miller and the Spellings Commission's encouragement, the US Department of Education proceeded to question the accreditation process at the six major regional accrediting agencies and pushed for the development or adoption of a standardized test to measure learning outcomes - including what emerged as the Collegiate Learning Assessment (or CLA). The owners of CLA generated the test via a "non-profit" modeled on the Educational Testing Services and, of course, supported any new federal requirements that would force accrediting agencies to eventually use "learning outcomes" tests or lose their approval by the US Department of Education.

The Spellings Commission's gambit to link accreditation with learning outcomes testing, however, became mired in a political battle after the 2006 elections. Democrats gained a majority in the House of Representatives and generally had a more skeptical view of the Bush administration's educational agenda and support for the FP sector. Public and nonprofit universities and colleges found sufficient support among Democrats to block the Bush administration's planned intervention in the accreditation process - including the fact that there was no evidence that tests like the CLA could actually gauge learning outcomes across the many disciplines.

This close scrutiny of the accreditation process by the Spelling Commission for traditional public and nonprofit colleges and universities, however, stood in contrast to a nearly non-existent concern with the activities of the FP sector. With the removal of the 50 percent limit, many FPs -- some new enterprises, and some the result of mergers -- successfully sought and gained regional accreditation in both traditional and career oriented accrediting programs.

The six regional accreditation agencies remain the gold standard for public and private nonprofit universities, while national accrediting entities, like the Accrediting Commission of Career Schools and Colleges (ACCSC), the Accrediting Council for Independent Colleges and Schools (ACICS), and the Distance Education and Training Council Accrediting Commission (DETCAC) provided easier paths for FPs. These national accrediting agencies are approved by the US Department of Education and hence provide FPs with access to federal financial aid funds.

However, most regionally accredited colleges and universities do not recognize transfer course credits from the nationally accredited institutions. They generally suspect low quality courses that do not meet their standards. Hence, many unsuspecting FP students who wish to transfer to another and more traditional tertiary institution find that their FP courses, and financial investment, are not worth anything. Recognizing this market disadvantage, corporate FPs sought regional accreditation, sometimes by buying a struggling but already-accredited nonprofit institution.

### Growth and Characteristics

The reestablishment of the 90/10 percent rule, the elimination of the 50 percent limit, the improved accreditation environment for the FPs, and a growing enrollment demand, all had a very positive effect on Wall Street. Large, corporate FPs became a hot stock pick and share prices rose dramatically.

Today, there are a number of major industry players in the FP sector, including the Apollo Group (owner of the University of Phoenix), Education Management Corporation (EMC), Career Education Corporation (CECO), Corinthian Colleges, DeVry, Kaplan Education (which also provides college test preparations services to high school students), and ITT Education Services. All are traded on the US stock market, and all have enrollments over 50,000, with Apollo by far the largest at nearly 400,000 students in 2010. In 2009, Apollo had revenues of some \$4 billion and a profit of \$598 million (Blumenstyk and Fuller, 2010).

**Table 1 - Enrollment Growth Among the Largest Publicly Traded US FP's: 2008-2009**

Source: Blumenstyk and Fuller, 2010

	Fall '09 enrollment	Growth over '08	Notes
Apollo Group (U. of Phoenix)	443,000	22.3%	New orientation program could lead to slower growth for its U. of Phoenix, the largest private university in the country.
Education Management Corporation	136,000	22.7%	Best known for Argosy U. and Art Institutes brands, it believes national focus on health care could now be a boon to its Brown Mackie College and South U.
Career Education	113,900	18.6%	Even after selling some unprofitable brands, its colleges and programs run the gamut from culinary arts at Le Cordon Bleu in the United States and Canada to master's programs offered online at American InterContinental University.
Kaplan Higher Education	108,300	28.0%	Kaplan is owned by the Washington Post Corporation and is a relatively new enterprise in providing tertiary degrees and certificates.
DeVry	101,648	37.1%	Known for programs in information technology and business, and a Caribbean medical school, it has recently expanded, with nursing offerings and an acquisition in Brazil.
Corinthian Colleges	93,493	25.9%	Its focus on students enrolled for certificates (64 percent) and associate-degree programs (31 percent) will be reinforced by its recent purchase of Heald College.
ITT Educational Services	79,208	28.7%	Known historically for the information-technology emphasis of its sole college, ITT Technical Institute, it is diversifying with the purchase of the formerly nonprofit Daniel Webster College, in New Hampshire.
American Public Education	55,300	42.2%	Its flagship, all-online American Military University draws 67 percent of its students from the ranks of the military but is now looking to diversify its enrollment base.
Bridgepoint Education	54,894	79.7%	Its biggest arm, Ashford University, uses its online offerings and liberal transfer policy to cater to students seeking to complete their degrees.
Strayer Education	54,317	21.9%	Founded in 1892 and known for its slow and steady growth in the mid-Atlantic and South, and more recently online, Strayer's largely adult enrollment is focused on bachelor's (56 percent) and masters programs (27 percent).
Grand Canyon Education	34,218	55.8%	This six-year-old company considers the Christian focus and online offerings of its namesake university as crucial pieces of its enrollment draw, which includes 62 percent in pursuit of master's degrees.

Education Management Corporation owns a number of FP's, including the Art Institutes, Argosy University, Brown Mackie College, and South University. Total enrollment for EMC is around 80,000. CECO is the result of a series of mergers in the

1990s and has a total enrollment of nearly 120,000, some of which, like Apollo, is in other countries – particularly in South America.

While there are about nine major FP corporations, each with HEI's that are accredited, the sector is largely composed of many small branch campuses. In 2010, FP included some 2,900 institutions and affiliated campuses, representing more than 40 percent of all the accredited colleges and universities in the US. Yet their total enrollment is just less than 10 percent of all enrollment in the 50 states. CECO, for example, has some 90 “campuses” (often rented space in shopping malls or in large office buildings, which they often own). The significant use of online courses, or various mixed hybrid? courses (with online combined with some limited personal contact with instructors at one of the campuses) is an important part of the funding model (Blumenstyk and Fuller, 2010).

Another important characteristic is that the FP's have a more distinct market than their public and nonprofit counterparts. While the sector is growing in the number of students enrolled and offers an associate, bachelors or graduate degree, it is largely in fields that relate directly to the labor market. Over 56 percent of the entire BA degrees awarded by the FP sector were in “business and administrative services,” in contrast to public universities, where the percentage was 19 percent of all BA degrees awarded. Also, the vast majority of students in FPs are much older than the traditional college age cohort of 18-24. Among these older students (on average), the greatest growth has been among female students. In 2000, they represented 57 percent of all FP enrollments; seven years later, they had grown to nearly 65 percent. In contrast, enrollment at public and nonprofit HEI's remained relatively level at 56-58 percent.

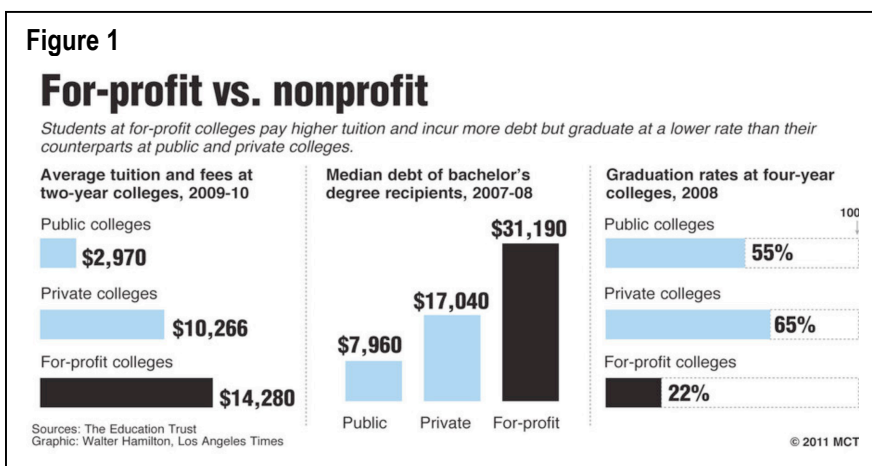
Among the largest FP's, profits have grown enormously between 2000 and 2010, and bolstered by increased enrollment demand in the wake of the Great Recession (see Table 1). Economic downturns tend to push up demand for tertiary education, in part because unemployed workers enter the market looking for ways to retrain and improve their employability. The recession also saw an upward trend in the number of part-time workers whom, for similar reasons, sought to enroll in FPs to further their education. Financial constraints on the ability of public colleges and universities to grow in enrollment and programs also resulted in new market opportunities for FPs. A stock index that includes the twelve largest FPs increased over 700 percent in value between 1996 and the end of 2009.

### Bang for the Taxpayer's Buck

Barack Obama's election as president in late 2008 corresponded with Democrats taking control of both the House of Representatives and the Senate, and a new interest in regulating markets in the midst of the financial collapse initiated by failures in the banking industry. Renewed concerns about consumer protection led to new Obama appointees in the US Department of Education, and congressional leaders in his party, to focus on the benefits and costs of the FP sector.

In a significant shift from the Bush era, congressional democrats and the Department of Education focused on the financial model of FPs amid concerns about growing abuses in the industry particularly among vocational schools in recruiting new students, low graduation rates, the high debt levels of students, and how many FP graduates became “gainfully employed” in a reasonable period.

Again, and like their public and nonprofit counterparts, there is a great array of FP institutions of varying quality. Another common thread: the FP sector is highly reliant on taxpayer funding. Although the product of rising demand for higher education, the current FP sector is not the result of free-market capitalism. It is heavily subsidized, with most major and minor enterprises relying heavily on students who receive federal and state financial aid.



For example, the Apollo Group, owner of the University of Phoenix, derives over 80 percent of all its revenues from their students' federally funded grants and loans. In the boom of increased enrollments over the past eight or so years, taxpayer funds and secured loans ranged from 80 to 90 percent of all income for the majority of the FP sector – hence the push by their



lobbyists in 2005 to alter the federal rule that at one time limited FPs from deriving no more than 80 percent of income from taxpayer subsidized financial aid (The Education Trust, 2010a).

One indicator of the FP sector's success in attracting students who are eligible for various forms of federal and state financial aid (state's vary in what aid they offer) is that while enrolling nearly 10 percent of all students in accredited higher education institutions, they secure some 24 percent of all Pell Grants – the main federal grant-in-aid for low-income students. They also secure over 25 percent of all subsidized and some 28 percent of unsubsidized federal student loans otherwise known as Stafford Loans (Baum and Payea, 2011).

Federal subsidies, particularly loans, would not be necessarily problematic for Washington if students graduated, gained employment, and paid back their loans. But a substantial number of students who enter the FP sector do not accomplish this feat. "Bachelor's degree completion rates are much lower in the for-profit sector than in other sectors," notes a study by the College Board. Of first-time full-time students who began studying for a bachelor's degree at a four-year institution in 2002, 57% earned a B.A. within six years. At FPs, only 22 percent earned degrees within six years. This is an industry average, with some providers in the range of 30 percent completion, and some closer to an average of 10 percent (Baum and Payea, 2011).

There are a number of variables that help explain these diverse completion rates. One is that the FP sector caters more, on average, to a lower income and minority population. According to 2007-08 data, some 54% of all the enrolled students in FPs reported family incomes below \$40,000 – close to the threshold for being eligible for Pell Grants. Only 6 percent of the students came from families with incomes above \$120,000 (currently the popularly accepted divide between upper middle class and upper class). In public four-year universities (doctoral granting), the percentage of students from low-income families is 21 percent and in private non-profit universities it is around 17 percent. Wealthy students (with family incomes above \$120,000) represent about 24 percent at these public universities, and some 34 percent at America's private universities. Even the two-year community colleges have few lower income students than the FP sector – about 35 percent (Baum and Steele, 2010).

On the one hand, these statistics indicate that the FP sector is serving an important segment of American society, creating opportunities for lower income and often minority groups – particularly in states that are cutting back on funding public higher education and sometimes limiting enrollment to contain costs. On the other hand, one can argue that the FP sector specifically targets these students because they are eligible for financial aid and can, therefore, increase income and profits.

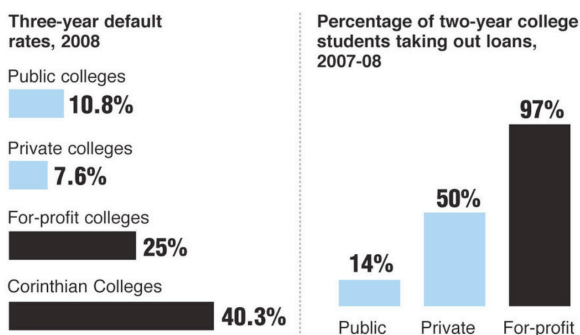
Another variable relates to the relatively high cost of attending a FP institution. While there are important differences in the programs offered, and the financial aid available to students attending public and private HEI's, the average real (after grants) costs tell a story. According to a study by The Education Trust, the average tuition and fee price in 2008 for an FP institution was \$14,280; at a public four-year university and a public two-year community college were just under \$5,000 and \$1,420 respectively. The average nonprofit private college tuition price was just over \$10,266. (See accompanying Figures 1 and 2 for sample outcomes data.) This contrasts with the high cost of the most expensive nonprofit HEI's (like Stanford or Harvard) of approximately \$34,000 (The Education Trust, 2010b).

But more important is the disparity of average debt levels of graduating students. One way to look at this is the ratio of average debt divided by degrees and credentials produced, thereby giving an indicator of productivity. A recent study by Kevin Carey and Erin Dillon found that the average ratio at public four-year universities was \$16,247 for each degree produced. At private nonprofit colleges and universities, it was \$21,827. For-profit universities, by contrast, produced \$43,383 in debt for every degree. "This difference is arguably even more significant than it seems," they explained. "While public and private four-year institutions are overwhelmingly in the business of granting four-year degrees (90 percent of their undergraduate degrees were bachelor's degrees in 2008–09), for-profit four-year institutions tend to grant significant numbers of two-year associate degrees and shorter-term credentials (56 percent of their degrees in 2008–09). These less-valuable credentials should presumably cost

**Figure 2**

## Heavy debts, high defaults

*Students at for-profit two-year colleges take out loans and default on them at higher rates than their peers at public and private schools.*



Sources: Department of Education, Height Analytics, The Education Trust  
Graphic: Walter Hamilton, Los Angeles Times

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students less, yet the amount of debt taken on by students to obtain them is significant” (Carey and Dillon, 2011).

With relatively low student aid given by the average FP, higher student to faculty ratios, limited student services, no expenditures on research activities, and limited capital expenditures, their operating costs are much lower in this sector. Yet the price is relatively high for the student, but not in upfront costs. FP have been highly effective in helping students secure taxpayer subsidized financial aid; but not very effective in graduating those students and helping them gain employment to then pay off their high debt levels. This has led to relatively high default rates among their former students.

Former students of for-profit institutions, both graduates and students who have withdrawn, have the highest federal student loan default rates among the sectors of higher education. In 2007 their default rate was 11 percent and, as the economy worsened, this figure climbed to 15 percent in 2009. By 2010 the average default rate was close to 21 percent. Public college and universities had a combined default rate of only 5.9 percent in 2007 and growing to 7.2 percent by 2009; private colleges and universities averaged an even lower rate of 4.6 percent (Nelson, 2011a). A study in April 2010 by the College Board found that 53 percent of for-profit-college students finish with more than \$30,500 in debt, compared to 12 percent of students at four-year public schools (Baum and Steele, 2010).

### A Congressional Hearing

On August 4, 2010, Senator Tom Harkin (Democrat-Iowa) gaveled into session what was to be the first of six hearings on the For-Profit higher education sector. Armed with the findings of the Government Accountability Office that reported predatory recruiting practices by 15 FP campuses that violated federal laws, Harkin's views marked a strong contrast to the open market leanings of Republicans and the past Bush administration. It was about consumer protection and federal spending. “Education is too important for the future of this country,” he said. “Facing the budget problems we have in the next 10 years, we just can't permit more and more of the taxpayers' dollars that are supposed to go for education and quality education ... to be going to pay shareholders or private investors” (Harkin, 2010).

The GAO report accused both the University of Phoenix and Kaplan College of paying recruiters bonuses for enticing and enrolling students, almost all of whom needed substantial taxpayer funded financial aid – a violation of federal law. There was also evidence that these and other FPs targeted veterans with benefits under the Post-9/11 GI Bill; they charged extremely high tuition rates for programs that, in Harkin's words, “may bring little benefit to future employment opportunities, low graduation rates and high default rates” (Harkin, 2010).

Senator Tom Harkin – News Conference on FP Sector



For Harkin and other Democrats on the Health, Education, Labor and Pensions Committee, there appeared more than enough evidence of systemic problems with the FP sector. For Republicans on the committee, now with a minority of members, the first hearing was viewed as an unfair attack on one component in a larger system of higher education. Completion rates in many public colleges and some universities with similar programs – often vocational – were also low. Community colleges, offering 2-year degrees and a variety of vocationally oriented credentials, have completion rates on average of around 22 percent.

The day after the first hearing, stocks of most publicly traded for-profits, including those visited by GAO investigators had closed down at the end of the day.

In the hearings that followed, lobbying groups from the FP institutions, along with those dominated by the public and non-profit sector, attempted to influence the investigation that Harkin had helped launch. Republicans on Harkin's committee sometimes refused to even attend hearings on the FP sector. Frederick Hess and Andrew Kelly at the American Enterprise Institute (a conservative think-tank) attacked the GAO report as inaccurate and misleading (Hess and Kelly, 2010). Several large FP chains established the Coalition for Educational Success intent on opposing "harsh and unnecessary regulations on career colleges," along with an organization called Citizens for Responsibility and Ethics in Washington (CREW) that claimed that the FP sector was being inappropriately targeted in government reports. Shortly after, CREW sued the GAO, accusing it of negligence and malpractice over what the suit called an “erroneous and completely biased” report criticizing commercial colleges (Blumenstyk, 2011).

But the sheer weight of the evidence of predatory practices, low graduation rates, and high debt levels generated national press

and momentum to address the problem in some fashion at the federal level (Harkin, 2010). Around the time of Harkin's first hearing on the FP sector, the US Department of Education announced plans to revisit regulations related to the industry – a seemingly coordinated and synergistic act. The focus was largely on predatory recruiting tactics, the high debt levels of most students who had enrolled in a FP, and revising existing rules on “gainful employment.”

The commercial colleges stated that the rule, as proposed, would cut off opportunities for low-income and minority students with too few educational options. The FP sector launched a multi-million dollar ad campaign in most major newspapers and news outlets, focused on the fact that the industry catered to low-income and often minority groups, and asking Americans to send their representatives in Congress to stop efforts to “over-regulate” these institutions. The consequence would be, the ads warned, a large reduction in educational opportunities in a time of a severe economic recession.

With the US Department of Education working on rule changes, and widespread bad publicity for the FP sector, some in industry began to realize that they needed to move toward better self-regulation, and to prepare for regulatory changes that would likely reduce profits and the value of FP stocks. At a closed two-day meeting in February 2011, the presidents of 32 regionally accredited career colleges gathered at the Princeton Club in New York City to discuss their common concerns and how they might work together to address them (Lederman, 2011). A study commissioned by the FP sector by Charles Rivers Associates estimated that 18 percent of current for-profit programs would not satisfy the metric first proposed by the US Department of Education (Guryan and Thompson, 2011).

In preparation for the battle with the Department of Education, the industry doubled spending on lobbying and hired six former members of the US Congress. Ten education companies and their trade

association spent well over \$3.8 million on lobbying in 2010, up from \$1.5 million in the comparable period last year (Laureman and Salant, 2010). Industry-paid advertisements urged citizens to contact their representatives in congress, with claims that the new gainful employment rules would cause, “400,000 students to leave post-secondary education each year, reduce lifetime incomes for these students by 15 percent; cause 90,000 to 100,000 job losses; and lead to a \$5.3 billion annual burden on taxpayers” – a figure presumably related to lost tax revenue from displaced students with lower incomes due to not getting a college degree (see Figure 3). Even more so, the assertion was that the impact would be disproportional, with the largest effects on students from low-income minority groups (Kantrowitz, 2010).

### A Federal Rule Change

The intense lobbying campaign did have a significant effect. When the US Department of Education eventually finalized the new “gainful employment” rules and other regulations in June 2011, the rules were less harsh than originally proposed and did not only target the FP sector (Douglass, 2010a). In speeches, Secretary of Education Arne Duncan stated that his office was only trying to go after a “few bad apples” while emphasizing the “vital role” for-profit institutions play in job training (Fuller, 2010).

On June 11, 2011, some ten months after the Department of Education announced it sought to better regulate the FP sector, the Obama administration came out with new regulations. The department had held 100 meetings with for-profit colleges and other stakeholders. For an institution's students to stay eligible for federal financial aid, the rules required both FP and nonprofit universities and certificate and vocational programs to demonstrate that at least 35 percent of their students are repaying their loans or that the annual loan payment does not exceed 12 percent of actual earnings 30 percent of a typical graduate's discretionary income, or 12 percent of their total income.

Figure 3 - Sample of FP Ad Campaign

**Please, keep your promise.**

**In 1965, America made a promise to millions of people seeking an advanced degree but lacking the resources to pay for it.**

**President Obama also made a promise.** To create jobs and hope for low-income Americans during his administration. We think he means it — but if so, why is his Department of Education writing a rule that will deny an education to hundreds of thousands of our most vulnerable citizens, who can't afford a post-secondary education without access to federal student financial aid?

**Promises, promises.** Americans are already hurting, with 18 percent of us unemployed or underemployed. The education offered by non-traditional degree programs helps thousands of low-income students start a career path each year. If the Department of Education's Gainful Employment rule passes, it will cost many of these students their access to higher education — and their career prospects. The cost to our country will be even greater.

**Unintended consequences.** If the Gainful Employment rule passes, it is estimated that this will cause 400,000 students to leave post-secondary education each year; reduce lifetime incomes for these students by 15 percent; cause 90,000 to 100,000 job losses; and lead to a \$5.3 billion annual burden on taxpayers as a result.

**Promises aren't made to be broken.** President Obama has pledged to support the very people the Gainful Employment rule will undermine. The Department of Education's rule will make advanced degrees, and advanced careers, even tougher to get for those who need them most. It's not too late to change the rule, but the time to speak up is now.

**This school rule fails on fairness.**

Stand up for choice and access in higher education.  
Talk to your Member of Congress about the Department of Education's new rule and its impact on low-income students.

**NBCC** National Black Chamber of Commerce  
Where Business Begins  
www.nationalbcc.org

These benchmarks of performance were considered the minimum that colleges had to meet to retain aid eligibility. But they were substantially lower than what had been first proposed by the Department of Education (Nelson, 2011b). Federal officials also gave FP colleges more time to meet the new standards and loosened several requirements on measuring debt and repayment. The first year that programs could possibly lose eligibility is now 2015, three years later than was previously proposed. Moreover, data collection to determine whether standards are met will not even begin until 2012, after the new measures take effect. Despite concerns over the targeting of veterans, the new rules had no specific elements to address these concerns. The 90/10 rule, in which FPs were required to have at least 10 percent of their operating funds coming from other sources besides the Title IV financial aid, essentially remained the same. Income derived from the GI Bill, the main source of financial aid for veterans, could be counted in the 10 percent.

Other regulations focus on appropriate practices for recruiting, including requiring that FP institutions notify students about the programs' costs and job prospects once they graduate, and the common practice of the sector to assign increased unit values for courses without increasing the time/work for the award of credit.

In the midst of a slowly rising stock market, and before the August 2011 plunge caused by haggling over the debt limit and new worries about the European financial crisis, FP sector stocks fell sharply. For the first time, Wall Street analysts projected a pending decrease in enrollment. Adding to the pessimistic outlook, a number of states followed the US Justice Department's suit for illegal recruiting practices.

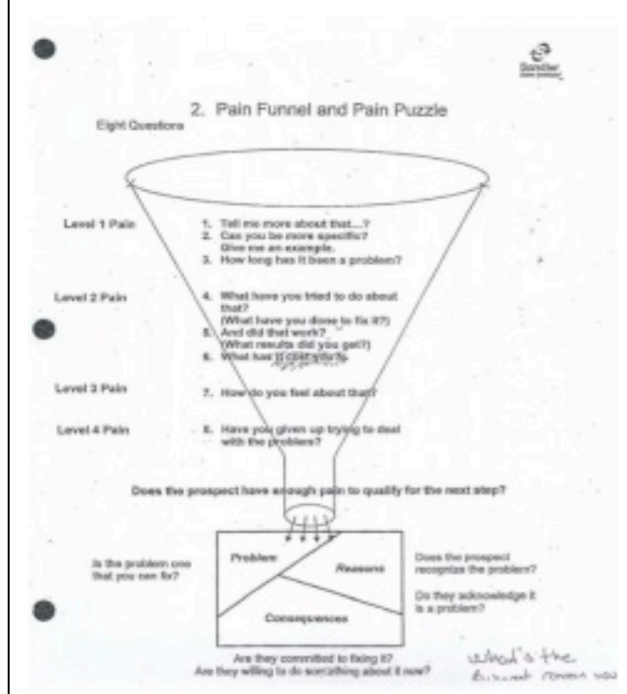
In California, the state attorney general announced her intention to review the state financial aid monies received by the Education Management Corporation since 2003. In 2009 and 2010, and with 14 campuses in California, EMC was the ultimate recipients of some \$93 million in Cal Grants intended for low-income students.

Other states also announced their own suits and investigations. By the end of August 2011, Florida's attorney general's office was investigating EDC, Corinthian Colleges, Kaplan, the University of Phoenix, MedVance Institute, Keiser University, Concorde Career College, and Career Education Corporation's Sanford-Brown College. The states of Delaware, Illinois, Iowa, Kentucky, Massachusetts, and New York had similar investigations launched or offered to join the federal suit (Perez, 2011).

This cavalcade of legal action came on the heels of a number of major exposés in major news outlets, like the *New York Times* and *Bloomberg Businessweek* that showed predatory practices. One example was Drake College of Business: with 87% of its total revenues coming from taxpayers, nearly 5 percent of its enrollment were homeless (Golden, 2010). An investigatory news show "Frontline" on National Public Television provided stories of individual students who had been duped into enrolling in largely vocational programs under false pretenses and were now loaded with large amounts of debt.<sup>a</sup> The show also featured a recruiter for an FP in North Carolina who, encouraged by his employer and motivated by a pay structured built on volume, signed up Marines with serious brain injuries.

The *New York Times* article entitled "In Hard Times, Lured Into Trade School and Debt," told stories of some FP's exaggerating the value of their degree programs, "selling young people on dreams of middle-class wages while setting them up for default on untenable debts, low-wage work and a struggle to avoid poverty" (Goodman, 2010). Another expose showed how

**Figure 4 - ITT Technical Institute Recruiting Manual**  
"Pain Funnel and Pain Puzzle" used by recruiters to reach the underlying pain and fear that motivates the unemployed, unskilled and underserved for potential students.



<sup>a</sup> Entitled "College Inc," the news program was aired on May 4, 2011. See: <http://www.pbs.org/wgbh/pages/frontline/collegeinc/view/>

ITT used ITT training recruiters to use a "Pain Funnel and Pain Puzzle" to ask prospective students in order to "poke the pain" and convince them to enroll (see Figure 4). "Remind them of what things will be like if they don't continue forward and earn their degrees," reads one document obtained from ITT Technical Institute, a for-profit school with more than 100 campuses across the country. "Poke the pain a bit and remind them who else is depending on them and their commitment to a better future." (Kirkham, 2011)

### **A Longer View – the “Brazilian Effect”**

Despite the long list of industry problems, the long-term prognosis is still good for enrollment growth and profits within the FP sector. In large part, this is due to a growing disjuncture between demand and supply. On the demand side, there are a number of important variables to consider. First, the US is one of the few developed economies growing in population. There are differences in various regions of the nation, with the most growth projected for large coastal states with higher than average concentrations of immigrant groups – such as California, Texas, and Florida. California alone is projected to grow from 37 million to 60 million by 2050. This insures growing demand for some form of higher education.

Just as importantly, the changing labor market will continue to push demand. The National Bureau of Economic Research states that there is a, “growing mismatch between the jobs that will be created over the next decade and the education training of our adult workers.” Those jobs that rely on workers with only a high school education or less are quickly receding in numbers and importance (Heckman, Humphries and Maden, 2010). Another recent analysis funded by a number of foundations looking to promote higher education attainment levels in the US, and worried over the progress of economic competitors, notes that, “Postsecondary education has become the threshold requirement for a middle-class family income,” and that the Great Recession is accelerating the shift in jobs that require a college degree. Yet the educational attainment level of both lower income families and the middle class is dropping (Carnevale, Smith and Strohl, 2010).

This trajectory is clear: in 1973, twenty-five million jobs required applicants to have at least some college education. By 2007, that number had nearly quadrupled to ninety-one million jobs. During that time, the percentage of jobs available to high school dropouts fell from 32 percent to 11 percent, while the percentage of jobs requiring some education after high school grew from 28 percent to 59 percent (Carnevale, Smith and Strohl, 2010).

In recognition of these trends, and noting the progress of economic competitors, President Obama announced in 2009 the goal that by 2020, “America will once again have the highest proportion of college graduates in the world.” He also asked that every American commit to at least one year or more of higher education or career training. “This can be Community College or a four-year school; vocational training or an apprenticeship. But whatever the training may be, every American will need to get more than a high school diploma” (White House, 2009).

To date, there is no credible plan for the US, or even individual states, to meet even modest projections for higher education demand. In part, this is due to the decentralized nature of America’s higher education system, where, as noted previously, states have jurisdiction over the size and shape of their public and private higher education sectors. With a number of exceptions for short periods of time, the federal government has limited its role to financial aid and the funding of basic research – with modest forays into the issues of quality and legal issue related to access and equity. And after a robust period of investment in expanding their higher education systems – largely in the post-World War II era and up until the late 1960s – state governments have increasingly followed a pattern of “disinvestment” in their higher education systems.

The Great Recession has accelerated these financial troubles for public colleges and universities, where currently some 80 percent of all students in the US are enrolled. In the mega-state of California, for example, it has led to estimates that in the 2010-11 academic year approximately 250,000 eligible students were denied access to the state’s public higher education system. Over 200,000 would have enrolled normally in one of California’s 110 community colleges; but the lack of funding and an extremely low tuition and fee policy resulted in large-scale decreases in the teaching staff and the number of courses that could be offered (Douglass, 2010b). Many of the community college programs are vocational, and can be viewed as a direct competitor with much of the FP sector.

America’s nonprofit higher education sector is, of course, an important player. But there is little reason to expect or hope that they will grow substantially in enrollment and programs – particularly in undergraduate and vocational programs. There have been very few new non-profit colleges or universities established in the last 50 years; the vast majority of the existing ones are quite content with the rising demand for their programs, and hence their increasingly selective admissions practices and ability to charge high tuition rates.

The inability of the public sector to meet current let alone future demand, means that California and other states are experiencing the “Brazilian Effect”: namely, and as noted previously, when public higher education cannot keep pace with growing public demand for access and programs, FPs rush to fill that gap. This is the pattern in many developing economies including Brazil. Unlike the American experience, there is only a small presence of large corporate FPs – although many US companies are attempting to change that. To be fair, Brazil has recently made significant strides to regulate its non-public providers through a new accreditation process to weed out or force improvement in the sector, and has pushed the development of three-year colleges oriented toward vocational degree programs. There is recognized value in the for-profit sector but a sense that it has taken up too much of the market share of higher education.

California is on the opposite side of the curve. There is currently a steep rise in enrollment in FPs in California precisely because of budget and enrollment cuts, as well as failure to expand degree programs within the state’s tripartite public higher education system and that includes the ten campus University of California, the twenty three campus California State University, CSU, and a network of 112 Community Colleges. Like in other parts of the US, and the world, FPs serve a large proportion of California students who come from “underserved communities,” and are on average from low-income minority groups. In 2008, 29 percent of students in California for-profits were from low-income backgrounds, and 31 percent were African-American, Latino, or Native American. And like the national averages, attrition rates in California at these institutions are very high and degree production rates low, and students end up with large debts (Carey and Dillon, 2011).

At the University of Phoenix campuses in California, where they have the largest presence in their global market, six-year bachelor’s degree graduation rates range from 10 percent in San Diego, to a high of 14 percent in the San Francisco/Bay Area. The University of Phoenix’s “Online Campus” has a national graduation rate of only 5 percent. Among four-year universities in California, for-profit institutions had the highest borrowing-to-credential ratios, with Westwood College’s South Bay campus topping the list. This institution produced \$121,145 in student debt per degree. As shown in Table 2, other schools with high ratios in California’s four-year for-profit sector include the Art Institute of California in Hollywood and the NewSchool of Architecture & Design in San Diego with total debt-to credential or degree ratios of \$112,062 and \$96,820 respectively (Carey and Dillon, 2011).

**Table 2 - Sample of 4-YEAR FOR-PROFITS in California with the highest Debt-to-Credential Rates 2007-2009**

Institution	Total credentials (2006-07 through 2008-09)	Total undergraduate debt (2006-07 through 2008-09)	Total debt-to-credential ratio (2006-07 through 2008-09)
Westwood College-South Bay	413	\$50,032,844.00	\$121,144.90
The Art Institute of California-Hollywood	316	\$35,411,719.00	\$112,062.40
NewSchool of Architecture & Design	80	\$7,745,679.00	\$96,820.99
Academy of Art University	2,285	\$192,244,921.00	\$84,133.44
The Art Institute of California-San Diego	1,350	\$101,056,821.00	\$74,856.90
Westwood College-Los Angeles	1,818	\$118,405,965.00	\$65,129.79
ITT Technical Institute-Torrance	846	\$53,285,720.00	\$62,985.48
The Art Institute of California-Los Angeles	3,011	\$184,937,597.00	\$61,420.66
ITT Technical Institute-San Diego	680	\$39,386,611.00	\$57,921.49
California College-San Diego	462	\$25,354,694.00	\$54,880.29

Some growth in the FP sector in California, and the US, is inevitable and good. A diversified market of higher education providers is an essential component to expanding access and graduation rates. In California, FP have grown in enrollments increased an average of 29% a year between 2000 and 2010. They generate some 12 percent of all degrees and certificates, including in vocational areas in which there is employment such as health professionals, culinary services, business management related fields, technicians and transportation and construction trades (Jez, 2011). They most directly compete with the Community College sector in California which has limited resources to properly gear more of their academic programs in these and other fields – even with the prospect of a modest boost from the Obama administration to better fund vocational programs in the nation’s two-year public colleges (CCC Chancellor’s Office, 2012). In short, they play an important role in California.

But it is likely that much of the FP sector will remain dogged by low quality and high attrition rates, and are relatively expensive for students, and for federal and state governments and ultimately taxpayers – in California and elsewhere. The American tradition of providing individual students with financial aid, which funded a higher education provider under a policy regime that began with the GI Bill, has had many benefits – including providing a more competitive market, and buttressed socioeconomic



mobility. Students can “shop around” to find the best programs that fit their perceived needs. But it has also supported a FP sector that is sustained not by the free market, but by large-scale public subsidization.

Ultimately, a nation-state, whether it is the US or any other country or region, should assess the benefits of allowing, regulating, and subsidizing its own FP sector. Should a portion of taxpayer funds that currently subsidize programs, and profits, in FP institutions, go instead to building capacity and programs in cashed starved public colleges and universities? Or perhaps a proportion of these funds could even be invested to allow growth within a select group of good quality nonprofits? What would be the cost and benefits of such an approach? At the same time, the US and states like California should more fully analyze the growing problem of mass access to higher education, and the low degree production rates. Here is a problem that does not belong to the FP sector alone (Lederman, 2010).

But let us return to the simplicity of demand and supply, and the short- and perhaps long-term prospect of declining public investment in higher education – the Brazilian Effect. It portends an optimistic future for the FP sector. As an article in the *Economist* noted, and despite some current doubts in the markets, “for-profit higher education is one of the greatest success stories in American business” (The Economist, 2010). Unlike public colleges and universities in the US, FP institutions can go to the market and generate income for future expansion. Increased regulatory oversight by the federal government, or by states, is possible. But as discussed in this paper, they are subject to intense lobbying by a FP sector that is gaining strength financially and hence politically, and at a time when the collective lobbying strength of public and nonprofits is likely to decline.

To a degree unmatched in the rest of the world, US politicians depend on raising large sums to run for election, and policymaking is shaped by the lobbying influences of special interests. This dynamic empowers the FP sector to get what it needs to grow in the higher education market place. Already, the FP sector is having a presence in the current campaign for the US presidency. With a sizable contribution to Mitt Romney’s campaign for the Republican nomination for president by Full Sail University, a FP based in Florida, Romney announced at a campaign stop in New Hampshire that the way to expand access to higher education and lower costs for students and their families was to enter FP institutions. This was the path, he stated, to “hold down the cost of education.” As a point of reference, it costs \$80,000 for a 21-month program in “video game art” (Lichtblau, 2012).

The politics might be different in various parts of the world, but the question is the same. How might the FP sector best fit into a national agenda for increasing educational attainment and the quality of the education rendered?

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