

# **The Case for Higher Education Reform**

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American Enterprise Institute

*Bradley Symposium*

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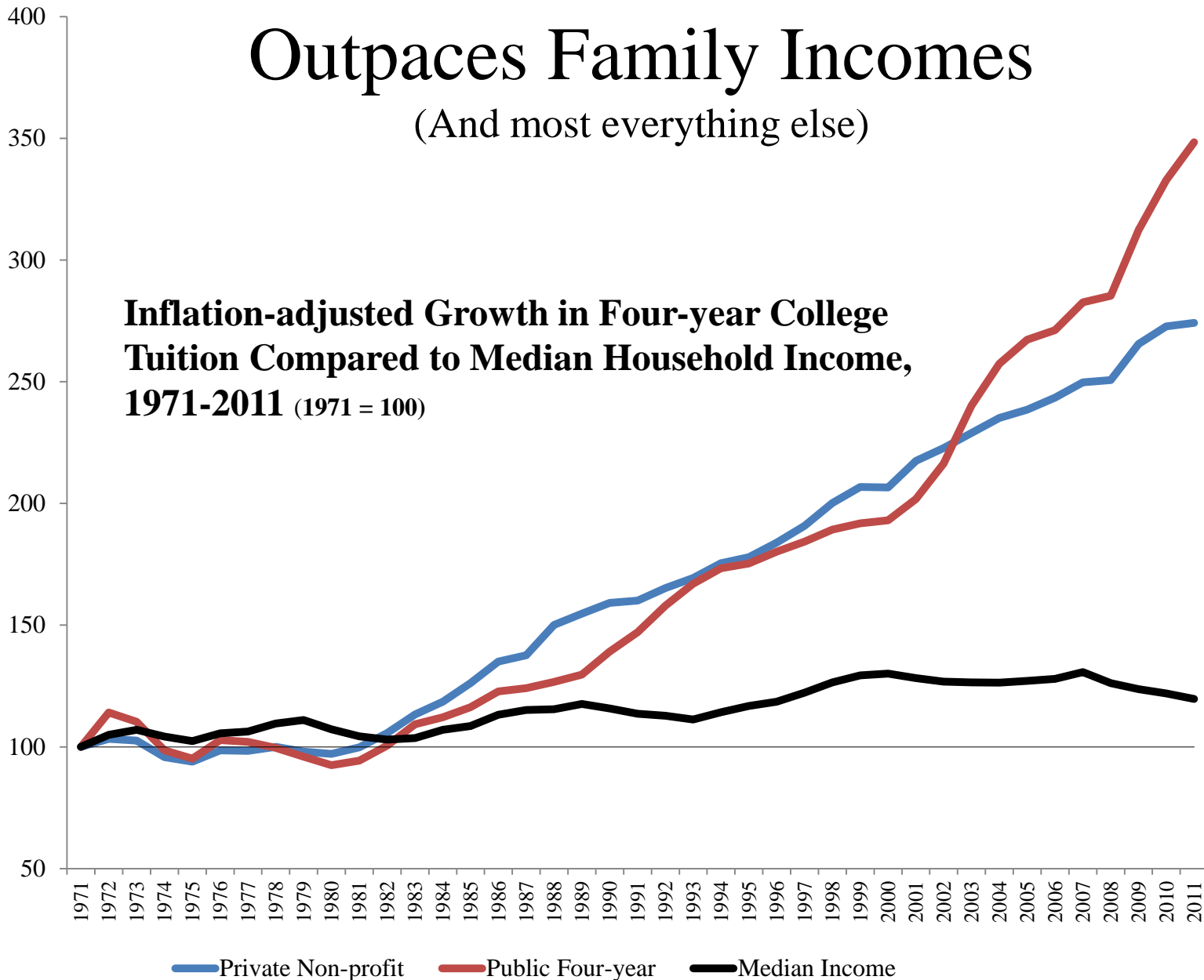
# Outline

- Why higher ed reform? Three trends.
- How did we get here? Four problems.
- What can we do about it? Four solutions.

# Trend 1: Tuition Growth Outpaces Family Incomes

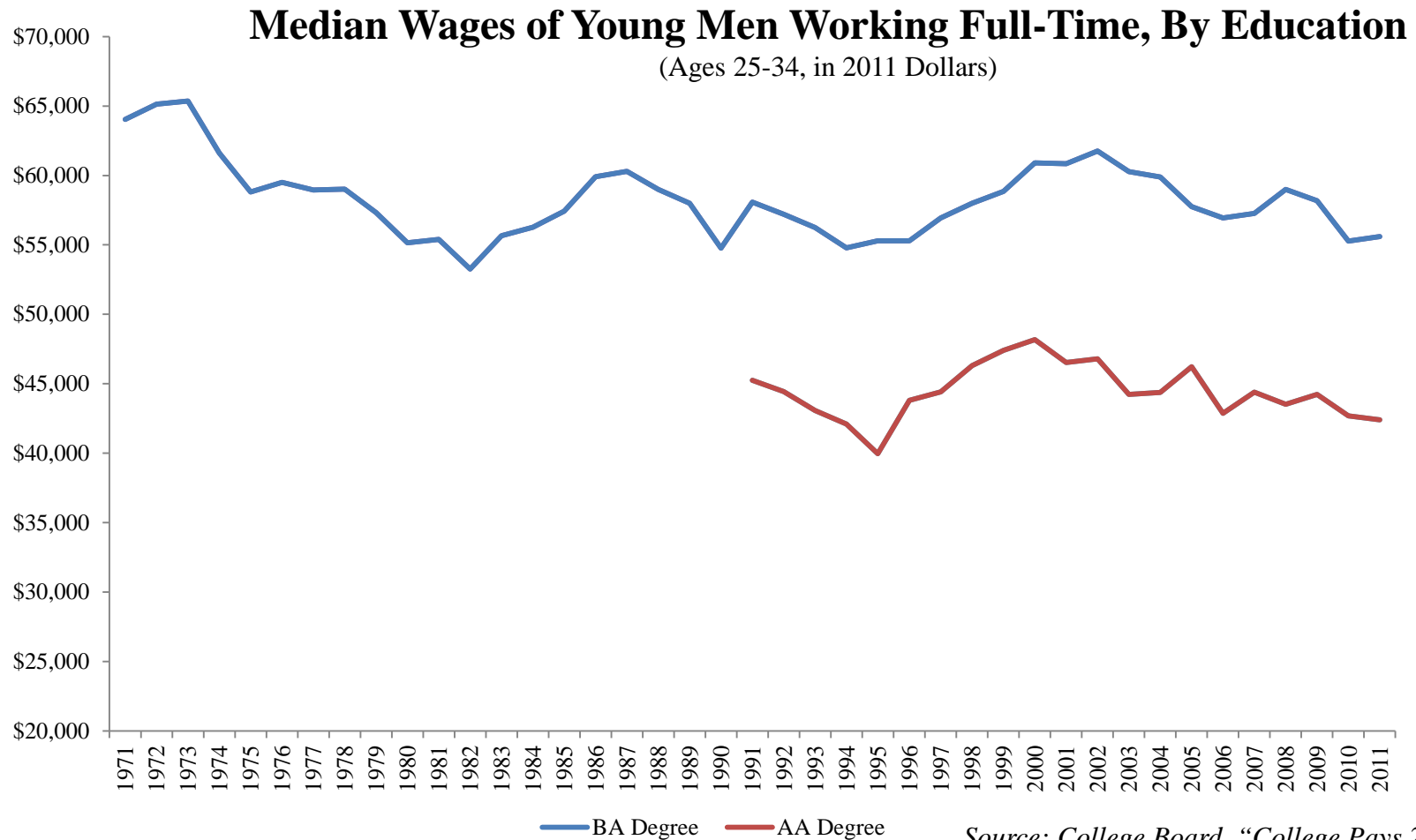
(And most everything else)

**Inflation-adjusted Growth in Four-year College  
Tuition Compared to Median Household Income,  
1971-2011 (1971 = 100)**



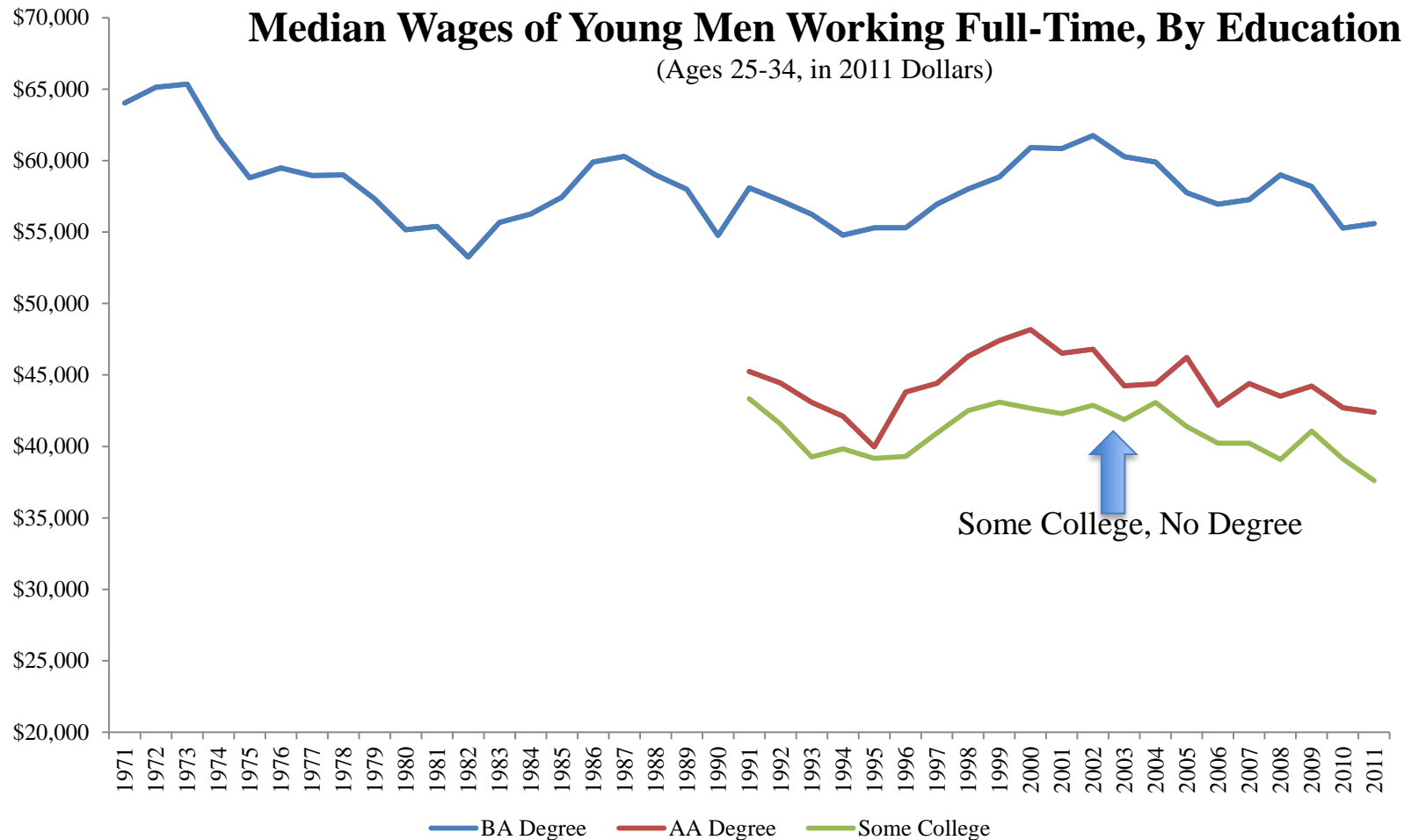
*Source: College Board, Census Bureau*

# Trend 2: Absolute Returns to a Degree Are Stagnant...



Source: College Board, "College Pays 2013."

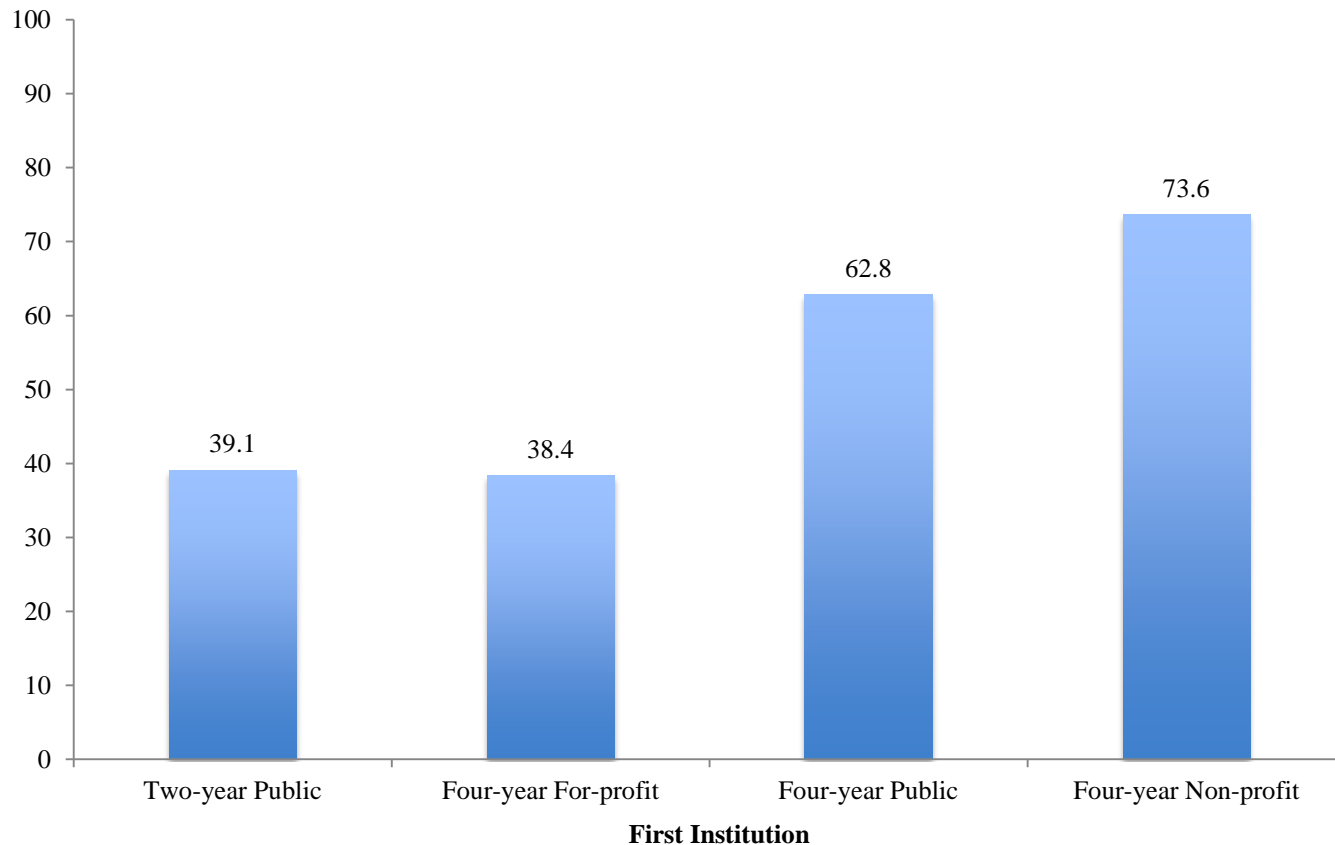
# Trend 2: ...And Drop-outs Earn Even Less



Source: College Board, "College Pays 2013."

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## Six-year Completion Rates by Starting Institution, 2008 Cohort



*Source: National Student Clearinghouse, 2014.*

# Trend 1 + Trend 2 = Struggling Borrowers

Among borrowers repaying federal loans...

Actively Repaying	Defaulted	In Deferment/Forbearance/Other
60%	16.5%	23.5%

*Source: Consumer Financial Protection Bureau, 2013.*

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THE NAZI DEATH CAMPS & THALIDOMIDE

SEPTEMBER 17, 2012

# Newsweek

Getting Sweaty  
With the GOP  
BY MARTIN AMIS



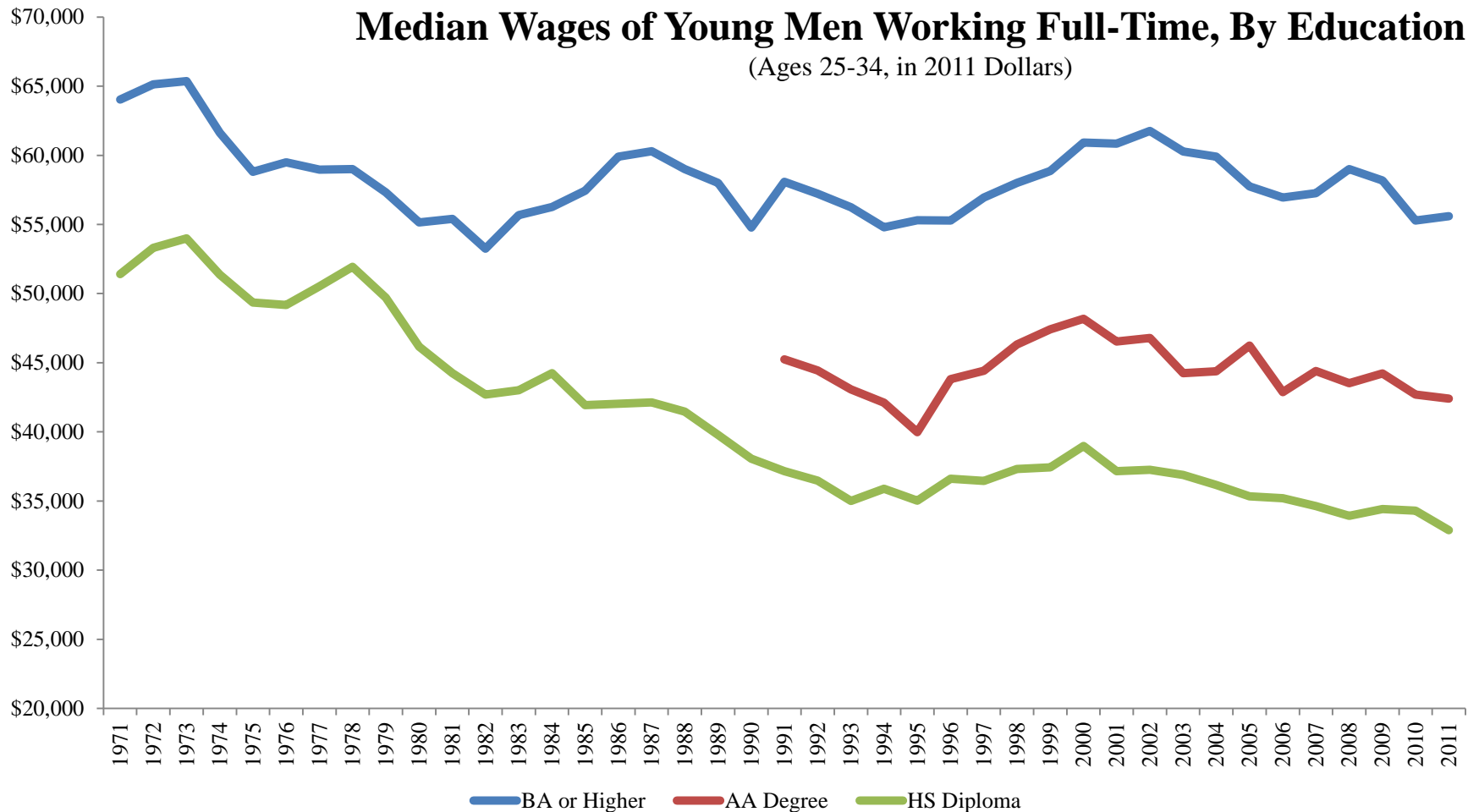
## Is College a Lousy Investment?

By Megan McArdle

JOHN  
ROBERTS  
HATES  
SURPRISES  
BY DANIEL  
KLAIDMAN

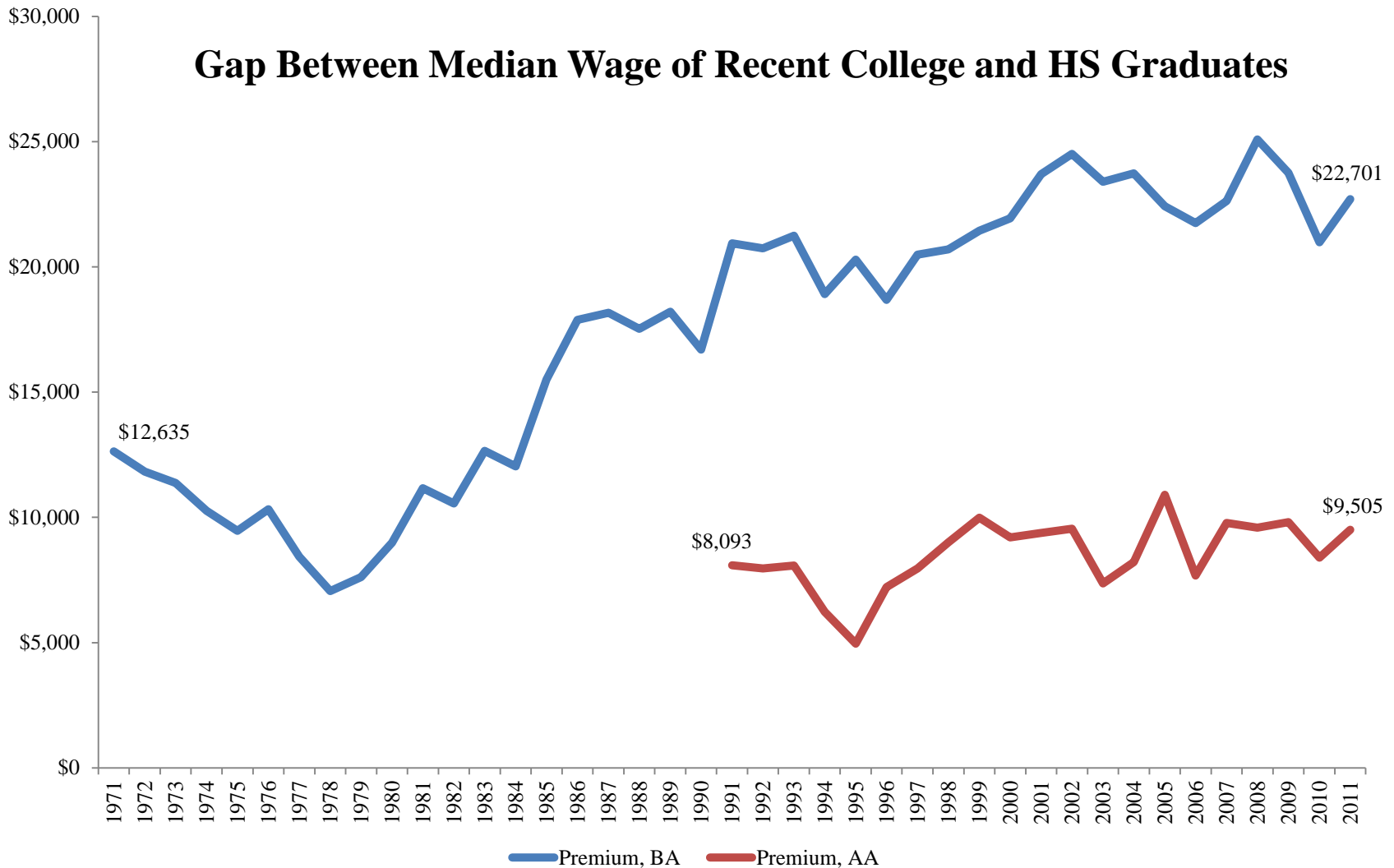
WHAT'S THE  
MATTER  
WITH NAOMI  
WOLF?  
BY MICHELLE  
GOLDBERG

# Trend 3: High School Graduates Have it Even Worse



Source: College Board, "College Pays 2013."

# Trend 3: Wage *Premium* Is Larger Than Ever



# The “College Conundrum”

Some education after high school is critical to economic mobility, but it is more expensive than ever.



Trapped: Can't afford to go and can't afford not to.

**How did we get here? Four problems.**

# Problem 1: Third-party payer, easy credit.

**Then: Federal student aid designed to solve under-provision problem.**



**Now: Large entitlement for all high school graduates.**



**Grants**

**Loans  
(Stafford and PLUS)**

**Tax benefits**



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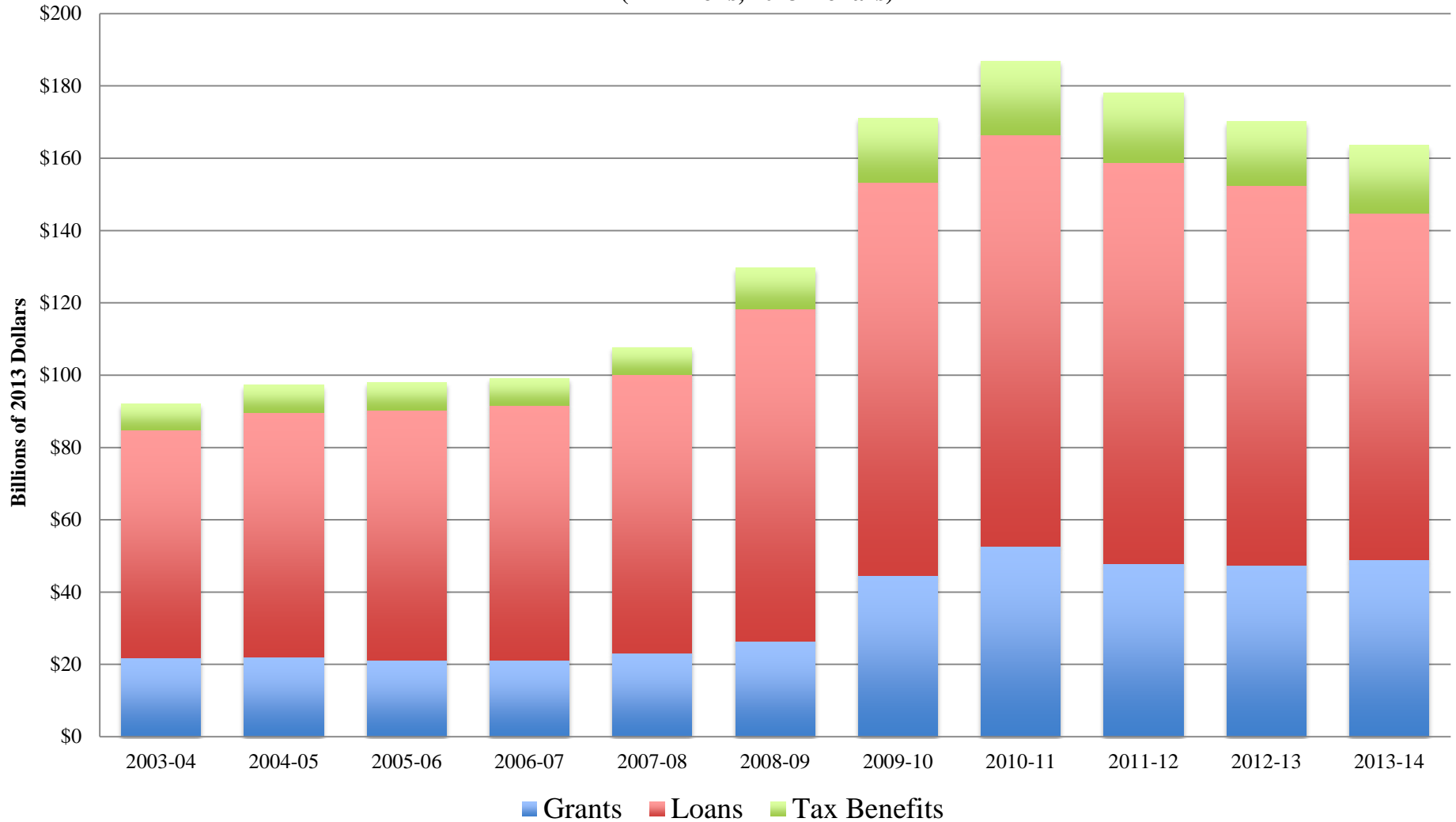
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# Federal Student Aid Disbursements, 2003-2014

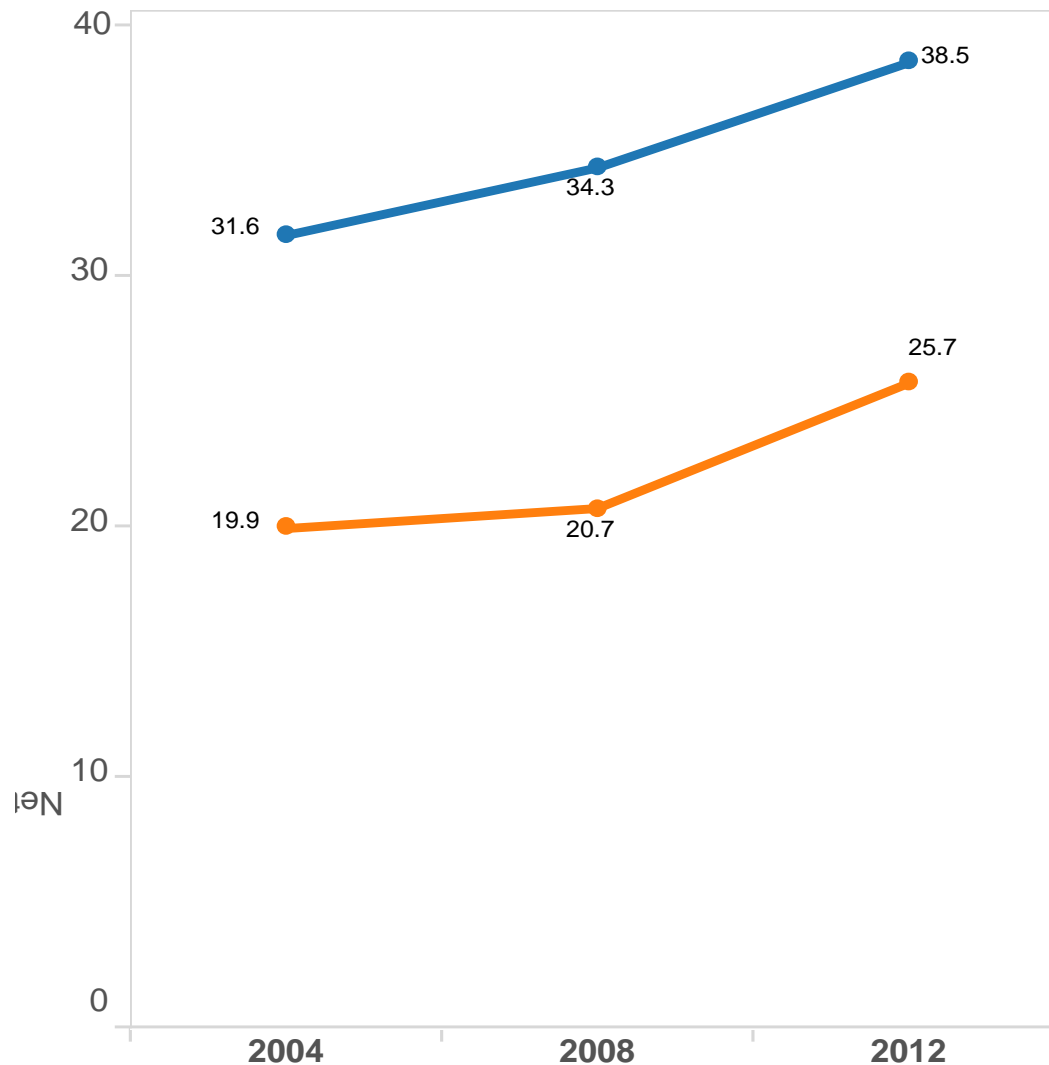
(in Billions, 2013 Dollars)







## Net price after grants as a percent of income for middle-income students by sector, 2004 to 2012



Source: National Center for Education Statistics (NCES), Postsecondary Student Aid Study (NPSAS), Assorted Years. Reproduced from Kelly (2014).

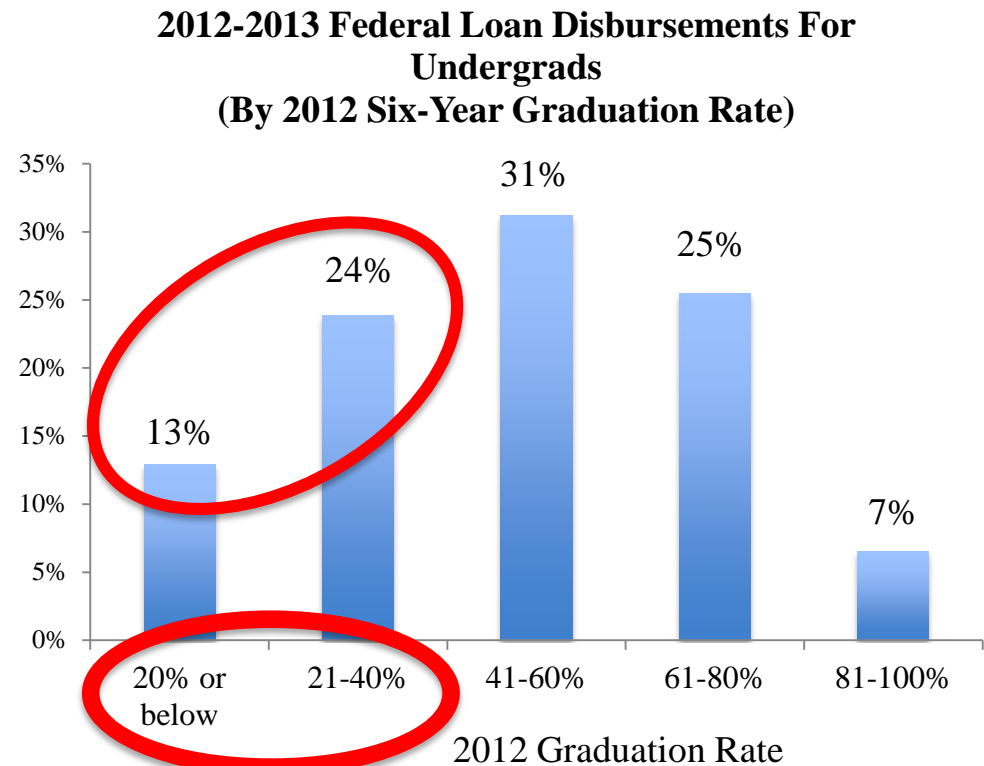
# Subsidize, Watch Tuition Rise, Subsidize Some More



Pouring more money into a system with misaligned incentives  
doesn't fix problems, and likely makes them worse.

## Problem 2: Inadequate Quality Assurance

- Almost no underwriting on federal loans.
- Regulatory “Triad” is ineffective gatekeeper: binary measures, conflicts of interest.





- Cohort Default Rate:
  - Below the threshold, schools held harmless.
  - Just 8 institutions sanctioned in 2011.
  - 2014: ED revised ratings for subset of schools.
- Accreditation:
  - Peer review.
  - GAO: 8 percent of schools were sanctioned over 4 ½ year period.
  - Just 1 percent lost accreditation.



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Bad colleges maintain access to federal aid.

# Problem 3: Imperfect Consumer Information

Nutrition Facts	
Serving Size 1 semester (4 credits) Servings Per College 8	
Amount Per Serving	
<b>Cost</b> \$3,871	<b>Room and Board</b> \$1,119
<b>Total Graduation Rate</b>	45%
Grad rate for your age	37%
Grad rate for your major	63%
<b>Average Aid</b> \$11,400	

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Limited ability to judge cost and quality blunts market discipline.

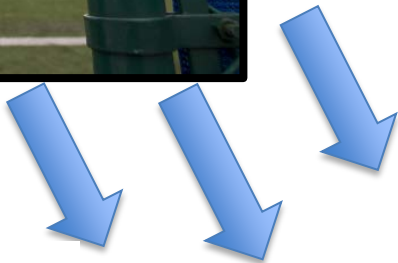
# Problem 4: Barriers to Entry

**Right now: Movement from logic of scarcity to abundance**



**But accreditation keeps new entrants out and reifies traditional model**

- Chicken or egg problem.
- Input-based.
- Cartel-like.





# Progressive Response: Spend More

- Expanded income-based repayment and loan forgiveness.
- Loan refinancing.
- Increase state spending.



# Progressive Response: Regulate more

- Gainful Employment.
- College ratings.
- Free college.



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**Premised on existing set of institutions and financial aid programs.  
But demands have changed, and our approach must change as well.**

**What can we do? Four solutions.**

# **Reformers Must Transform the Market**

1. Give colleges greater stake in student success.
2. Empower consumers to invest wisely.
3. Lower barriers to entry.
4. Create space for new financing tools.

# **Solution 1: Skin in the Game**

- Colleges originate loans and should retain some of the risk.
- Put schools on the hook financially for portion of loan defaults, and give a bonus for Pell graduates.
- Sets basic standard, colleges have flexibility to meet it.



## **Solution 2: Empower Consumers**

- Better data on costs, outcomes, and value are public goods.
- Feds should collect and make public so third-parties can create range of customized ratings.
- Prevent misuse by legislating prohibitions.



## **Solution 3: Lower Barriers to Entry**

- Opportunity to redefine what postsecondary education looks like and who can offer it.
- Create parallel path to eligibility for new entrants to access public resources.
- Horse trade: Organizations get more flexibility in exchange for transparency and accountability.



## **Solution 4: Create Space for Private Financing**

- Private financing could inject market discipline, but is largely absent.
- Income-share agreements: Investors finance students in return for percentage of future income for set period of time.
- Aligns incentives of financier and student and sends clear signals about value.
- Must resolve legal and regulatory uncertainty.