

UNTAPPED POTENTIAL

MAKING THE HIGHER EDUCATION MARKET WORK FOR STUDENTS AND TAXPAYERS

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Executive Summary

American universities continue to top international rankings and to attract the world's best students and faculty, leading policymakers and the public to assume the US higher education system is delivering top-notch educational value to its students.

Recently, however, significant cracks have emerged in this facade of excellence. Lackluster graduation rates, rising delinquency and default rates on student loans, and poor results on measures of student learning have raised alarm bells about the return on federal investments in student financial aid. In response, reformers have increasingly questioned the federal approach to ensuring that taxpayer dollars flow to quality institutions.

Decades ago, policymakers built a student financial aid (quality-assurance) system around two pillars: 1) consumer choice and 2) hands-off regulation that relies largely on higher education accreditation. Unfortunately, flawed assumptions about how these mechanisms ought to operate have never been updated, leading to a status quo of increasing costs, subpar outcomes, and lack of innovation.

In this paper—the first in a series of papers that will examine higher education quality assurance from a number of perspectives—we argue that policymakers should rethink the higher education system's building blocks in a way that protects consumers and taxpayers while maximizing educational opportunity. We advocate reforms in three specific areas.

Modernize, but Don't Expand, the Direct Federal Oversight Role. Policymakers should replace existing higher education regulations with two simple accountability mechanisms: a performance floor that would kick the worst-performing institutions out of federal aid programs and a risk-sharing policy that would give institutions skin in the game. These rules can be transparently and effectively implemented by the

Department of Education and would ensure a basic level of protection of taxpayer and student interests.

Delegate Responsibility, but to New Authorizers.

Policymakers should continue to delegate responsibility for direct oversight of academic quality. However, largely because of the nature of the entities accreditation relies on, the current process has both failed to ensure quality and stifled innovation. Therefore, policymakers should seek ways to bring in new authorizers—such as consortia of employers, nonprofit groups, or professional associations—that would be better suited to play an oversight role and be more receptive to innovative models. At the same time, policymakers should set clear expectations for performance and hold authorizers accountable, including giving them skin in the game when the providers they approve perform poorly.

Expand and Improve Market Accountability.

While market discipline is an essential part of the quality-assurance process, students currently lack the information and tools they need to evaluate the quality of different programs. Policymakers should take several steps to remedy this shortcoming:

1. Collect and publish better data on student outcomes, such as graduation rates and expected earnings, disaggregated by program.
2. Encourage new private-financing tools, such as Income Share Agreements, which would help students navigate to worthwhile programs.
3. Policymakers should cap federal PLUS loans to contain the ill-effects of giving consumers access to large amounts of loan capital with few questions asked.

Untapped Potential: Making the Higher Education Market Work for Students and Taxpayers

American colleges and universities are widely considered the best in the world. US research universities have consistently scored at the top of international rankings, and the United States boasts more Nobel Prize winners than any other country.¹ Each year, the world's elite line up in an increasingly competitive race to send their children to America's most selective post-secondary schools.²

This perception exerts a powerful influence on US higher education policy. Put simply, policymakers' deep faith in the quality of the existing system (and, in particular, of the schools in their district or state) has led them to be far less concerned about the top-to-bottom quality of the sector than we might expect, especially in light of the \$178 billion in federal money that flows there each year.³

After all, if you know your colleges and universities are the best in the world, why worry about the job they are doing? The result has been a federal higher education policy that is almost exclusively focused on ensuring access, with insufficient attention paid to whether the education students are accessing is worth the price of admission.⁴

However, a cursory examination of a range of student outcomes—such as graduation and loan default rates, labor market success, and basic numeracy and problem-solving skills among graduates—reveals serious cracks in the facade of excellence. Nationally, nearly one-half of the students who start a degree or certificate do not finish in six years.⁵ Those who do graduate are often ill prepared for the labor market.

On a 2013 international assessment of adult skills, America's college and university graduates scored below

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international averages on numeracy and literacy.⁶ And the effective student loan delinquency rate—which applies to, among others, students granted forbearance from payments because of hardship—is now as high as the delinquency rate on subprime mortgages at the height of the housing crisis.⁷

In the face of these discouraging outcomes, reform-minded policymakers on the left and right have raised alarm about the performance of America's higher education system. Specifically, the disconnect among growing federal investment, skyrocketing costs, and disappointing student outcomes has led many to question whether the policies that govern federal financial aid spending (quality assurance) are effectively protecting students and taxpayers and maximizing educational opportunity. This dissatisfaction has given rise to a number of proposals for how the system might be reformed.⁸

This focus on quality assurance is long overdue. Before leaping to embrace any particular agenda, however, policymakers ought to revisit the basic building blocks of the current system to identify how the assumptions of prior reformers have fallen short. Doing so can help us diagnose which elements of the system have worked well and which need to change, providing a clearer sense of where we should put these emerging reform energies to use.

The History of the Current Quality-Assurance System

In the mid-20th century, the federal government created a set of grant and loan programs to ensure that all qualified students would have access to some form of postsecondary education, regardless of family income.

As this system was being developed, policymakers made two fundamental decisions that have shaped the federal approach to quality assurance in critical ways.

First, aid would be given directly to the student, not the institution, and it would be portable. Policymakers assumed that providing vouchers (and later, tax benefits) to students and allowing them to choose a school would reward schools that offer high-quality programs and would punish those that fall short. In theory, these choices would create market forces that would hold colleges and universities accountable for their performance.⁹

Second, in light of concerns about the federal government wading into issues of academic quality, Congress took a hands-off regulatory approach, opting for a three-pronged, collaborative effort on the part of the Department of Education (previously the Department of Health, Education, and Welfare), federally recognized higher education accreditation agencies, and state governments. This structure is known as the triad.

To receive federal financial aid dollars under Title IV of the *Higher Education Act*, colleges and universities have to fulfill requirements at all three levels. Specifically, policymakers task accreditation agencies—private, nonprofit self-regulatory groups—with assessing academic quality. Additionally, schools must report data and prove to the Department of Education that they are financially viable. And lastly, they must pass requisite state licensure processes in any states where they operate.

The Department of Education's direct oversight expanded somewhat in the 1980s with the cohort default rate (CDR) rule, a tool designed to prevent schools with high rates of student loan default from accessing federal financial aid.¹⁰ The 90/10 rule (previously 85/15 rule) was also developed shortly thereafter to regulate the amount of revenue for-profit colleges and universities could draw from Title IV programs.¹¹ Proprietary institutions must receive at least 10 percent of their revenue from sources other than Pell Grants (federal need-based grants) and student loans to remain eligible for the program.

The original assumption was that these two mechanisms—market discipline through consumer choice and hands-off regulation via the triad—would ensure that federal higher education dollars were well

spent. Unfortunately, there is a widespread sense that they have fallen short.

Reexamining the Building Blocks

Growing frustration with the cost and quality of American higher education has led policymakers and researchers to look more closely at which facets of the current quality-assurance system have not operated as expected.

Market Accountability? Policymakers and analysts have questioned whether students and parents have access to the tools and information necessary to make informed school choices and exert market discipline. As President George W. Bush's Commission on the Future of Higher Education concluded in 2006, higher education suffers from a "remarkable shortage of clear, accessible information about crucial aspects . . . from financial aid to graduation rates."¹²

In well-functioning markets, consumers can readily evaluate the cost and quality of products being offered, giving rise to a natural sorting process that rewards producers that offer higher-quality products at a lower price. Evaluating the quality of postsecondary institutions and programs is a difficult task, however. Part of this is because of the nature of the good: a postsecondary education is an "experience good," meaning it is difficult to assess the good's value before purchase.¹³ And most students only purchase a postsecondary education once or twice, meaning they have little opportunity to actually learn from experience.

Consumers also face a dearth of clear, comparable data on costs and quality. Some critical pieces of information, such as that on the return on investment for different programs at different institutions, are typically unavailable outside of a handful of states. Moreover, basic information, such as that on out-of-pocket costs of attendance and the percentage of students who complete a degree, is woefully incomplete. And while there are popular rankings that attempt to evaluate institutions and programs, they too lack access to key pieces of data that would allow the ranking systems to assess how much students actually benefit from enrolling in a particular school.

Evidence suggests that in the absence of good information about outcomes, some consumers rely on proxies such as institutional prestige, tuition prices, or spending on amenities, which are all more readily apparent but may not be correlated with actual educational quality.¹⁴ Meanwhile, consumers on the margin of attending a college or university are frequently encouraged to enroll in shoddy programs with promises of postgraduation success. With only limited ways to validate those promises, these disadvantaged students often wind up using federal grants and loans for programs that fail to deliver educational value.¹⁵

The accreditation process is also of little help. What was once a meaningful seal of approval now obscures more than it reveals. Institutions with very different records of success bear the same accreditation, meaning poor-performing schools, even those that have been placed on notice by their accreditors, can hide behind that imprimatur. Furthermore, accreditation reviews do not have to be made public, making it even more difficult to know how campuses stack up to one another.¹⁶

Thus, what policymakers originally envisioned as a functioning market that would reward the best institutions and punish the worst has fallen well short of that standard. Instead, schools are often rewarded for investing in prestige, raising their prices, and aggressively recruiting students.

Hands-Off Regulation? Policymakers have also begun to question whether a hands-off regulatory approach on the part of the federal government adequately ensures quality. Nowhere is this more apparent than in the push to reform accreditation, an experiment in self-regulation that has not played out as policymakers had hoped.

Accreditors have a poor track record in terms of ensuring quality. Hundreds of two- and four-year institutions remain fully accredited—and free to grow in size—despite graduating less than one-third of their first-time, degree-seeking students. Similarly, among those institutions receiving Title IV aid, nearly 490 schools had three-year cohort default rates of 25 percent or higher in 2014.¹⁷ And when schools have been literally put to the test, the results have often been discouraging.

On a recent international assessment of skills, American college and university graduates scored well

below international averages on a test of basic numeracy.¹⁸ Before those results, a pair of sociologists found that more than one-third of undergraduates at a set of four-year institutions did not show meaningful gains on an assessment of critical thinking over four years of school.¹⁹ Many of those former students are now working low-wage jobs that do not require a postsecondary degree.

Hundreds of two- and four-year institutions remain fully accredited—and free to grow in size—despite graduating less than one-third of their first-time, degree-seeking students.

There are several reasons for this failure of effective oversight. Accreditation agencies face a clear conflict of interest when it comes to regulating colleges and universities: they are sustained with dues from the schools they regulate, and accreditation reviews are conducted by faculty from peer universities. Fundamentally, accreditation was designed as a process of self-regulation or peer review and, as such, was never intended to serve an external accountability role. Yet federal policy assumes that schools will police each other.

Accreditation is also a binary variable (colleges and universities either have it or they do not), and because federal aid is the lifeblood of many institutions, losing eligibility would put most in severe financial distress. This creates a barrier to exit, as accreditors—already sympathetic to the institutions they evaluate—are reticent to revoke a school's accreditation because doing so would represent a death sentence. Therefore, poor-performing schools are allowed to muddle along, propped up by continuing access to federal funds as they move on and off accreditors' watch lists. It typically takes years of chronic failure before the seal of approval is lost.²⁰

Furthermore, accreditors seemingly do not need to be particularly concerned about losing their delegated power if they continue to approve poor-performing institutions. The Department of Education has only rarely derecognized an accreditation agency for poor

performance. This provides accreditors with weak incentives to do the controversial work of holding their member institutions accountable.

In addition, the accreditation process has served as a barrier to innovation. To get accredited, schools must have served students for at least four to five years. However, to attract students, most new educational organizations must have access to federal grants and loans that enable students to afford the price of admission. New providers that cannot afford to self-finance during that time will struggle to survive. Thus, market entry—a vital source of new ideas—is severely constrained.

Beyond the obstacles to new market entrants, accreditation's focus on inputs leaves little room for innovative models. Accreditation reviews focus on the facets of what is traditionally labeled a college or university—faculty credentials, facilities, learning resources, and mission statements—rather than the outcomes those components produce.²¹ Organizations that look nothing like brick-and-mortar campuses face a long and uncertain approval process. And those that provide postsecondary courses but no degrees or certificates cannot get accredited.

In short, the primary means by which the federal government ensures academic quality has the dubious distinction of simultaneously keeping poor-performing schools in business while keeping new organizations out.

What about the Other Parts of the Triad? Accreditation's design flaws would be less problematic if the other pieces of the triad were better able to hold colleges and universities accountable for their performance. Unfortunately, federal and state oversight is similarly handicapped.

Like accreditation, state authorization processes often assess quality based on a particular set of inputs. New educational organizations must navigate licensing processes that are burdensome, expensive, and of questionable value in terms of ensuring educational quality. At the other end of the spectrum, some states merely take a rubber-stamp approach, which poses its own problems for consumer protection. When it comes to public colleges and universities, accountability systems vary dramatically across states, and most locales continue to fund public colleges and universities based purely on enrollments rather than student outcomes.²²

At the federal level, cohort default rates—the one lever designed to hold all colleges to minimal performance standards—are easily gamed: they only measure defaults over a limited, three-year window. If students default after three years, they are not part of the calculation, and an entire industry has emerged to help colleges manage defaults.²³ Meanwhile, the 90/10 rule and measures of financial health may be completely unrelated to educational quality.

Dismantle the Building Blocks?

In sum, the main building blocks of higher education accountability—market discipline combined with limited government-sponsored quality control—suffer from significant structural problems. Consumers do not know enough about what they are purchasing. And the web of shared oversight via the triad has both failed to ensure quality and stifled innovation. As a result, policymakers have made increasingly large amounts of federal funds available without effective means to ensure that those funds are well spent.

In light of this poor performance, some researchers and policymakers are now advocating a shift away from one or both of these foundational building blocks. The temptation is to substitute federal power for the failures of the market and accreditation. We examine two such proposals in this section: 1) creating a more muscular federal role in determining eligibility and accountability and 2) moving away from a market-based approach and toward one where the federal government directly subsidizes and controls schools. While these proposals merit serious discussion and consideration, we believe they suffer from their own design flaws that could undermine some strengths of the current system.

A More Muscular Federal Role. Some reform proposals seek to expand the Department of Education's direct oversight role while preserving the basic consumer choice framework of the current system. The most prominent example of this approach is President Obama's proposal to create a ratings system for colleges and universities.

As proposed, the federal government would evaluate institutions based on measures related to access,

affordability, and outcomes, with the goal that an institution's broad performance rating would eventually determine its students' eligibility for federal grants and loans.²⁴ Furthermore, while not part of President Obama's plan, some researchers have argued that, with a more robust system such as this in place, accreditors could be removed from their current gatekeeper role, thus moving entirely away from the hands-off approach the federal government has taken with the current system.²⁵

There are good reasons to be skeptical about such proposals. The US postsecondary education system features a diverse array of institutions offering a wide variety of programs. The goals, outcomes, and value propositions of these programs vary widely, so defining outcome measures that reflect the diversity of the programs available to students is inordinately difficult.

For example, affordability is a measure that will vary dramatically across different types of institutions and programs, depending on the expected benefits. One program may appear expensive but still be a good investment once the potential returns to that type of program are considered. Other programs might appear low priced but are actually quite expensive when reexamined in terms of return on investment. Attempts to measure student learning gains may hit similar stumbling blocks, with a wide array of potential outcomes—including licensure pass rates and direct assessments of student learning—being appropriate for different types of programs.

It is possible, in theory, to design an elaborate accountability system that is managed by the Department of Education and reflects this diversity. But it is questionable whether the federal government has the capacity to fairly, accurately, and transparently implement and manage such a system. Such complexity gives rise to implementation difficulties, and the more complicated a set of regulations, the easier it is for self-interested actors to exploit legitimate measurement and design concerns to challenge the entire system. And when accountability mechanisms start to pinch, policymakers are inevitably tempted to water them down to address the concerns of established actors, legitimate or not.²⁶

Unfortunately, these challenges make it difficult for the federal government to assume the bulk of the task of quality assurance. It seems simple to “just have

the feds do it directly.” But that simplicity belies a failure to consider what tasks the federal government can effectively and sustainably accomplish. Without considering that dimension, it is possible to end up with a system that both fails to ensure quality and creates a series of unintended consequences.

Moving Away from Markets. Other researchers have advocated for a broader expansion of government intervention in higher education, proposing that federal funds flow directly to public institutions rather than to students in the form of a voucher. Institutions receiving those funds would then agree to accept more governmental control, particularly over what they can charge for tuition and fees. As education policy professor Sara Goldrick-Rab has argued:

The current [system] . . . is increasingly ineffective at helping students complete their degrees, unaccountable to the taxpayers who fund it, and fundamentally unfair. . . . The main tradeoff that [our free two-year-college option] makes is that it prioritizes accessibility, educational quality, and degree completion over consumer and institutional choice. Specifically, the range of providers financed by the federal government for the provision of the 13th and 14th years of education will be restricted to public colleges and universities. . . . In exchange for these resources, institutions will have to commit to charging students no tuition or fees, driving the sticker price to zero.²⁷

Moving to a more centralized higher education system would be a step in the wrong direction. To be sure, market accountability is not working nearly as effectively as it should be. But proposals for broader government intervention assume that once the federal government subsidizes colleges directly, it will be better able to compel those colleges to improve their outcomes and contain their costs. But is this necessarily the case?

To be sure, policymakers could conceivably control tuition prices through funding formulas and fiat. But they would have a much more difficult time ensuring that those institutions provide a quality education at the price they charge. Again, federal K–12 policy is instructive. The Title I program provides direct aid to improve

schools that serve disadvantaged elementary and secondary school students. Unfortunately, despite years of effort and billions in direct subsidies, the federal government has not been very successful in these efforts.²⁸

One of the major challenges that such a centralized system would face is what political scientists Jeffrey Pressman and Aaron Wildavsky call the “complexity of joint action” in their classic study of implementation.²⁹ Federal policymakers write rules that tell college leaders what is expected of them and outline the consequences for not performing, the leaders have to tell academic deans and provosts to reform policies and practices to reach benchmarks, and deans and provosts then presumably tell front-line faculty how to change their behavior.

At each decision point, these agents can distort, pervert, or simply ignore the original intent, leading to disappointment. The suggestion that federal bureaucrats can control what goes on in college or university classrooms dramatically underestimates the complexity of institutions and of those founded on principles of autonomy and academic freedom.

What’s more, these proposals would sacrifice much of what has made American higher education successful: the variety of models designed to serve the distinct needs of different market segments. A heavily regulated “public option” would likely result in the kind of standardization and homogenization we have seen in K–12 education, where traditional public schools have looked essentially identical since the Progressive Era.

At the very least, this system would be hard pressed to enable the kinds of innovative ideas and delivery models that the decentralized, market-based model has produced. Moving to a more centralized higher education system risks undermining the diversity and dynamism needed to meet the needs of the 21st-century economy.

Building a Better System

The intensifying drumbeat for reform has created a window of opportunity to improve quality assurance. Fortunately, policymakers do not need to completely dismantle the building blocks of the current system, but they do need to think more broadly about how to modernize them. Building on lessons learned from

decades of experience with the current system, we outline concrete steps for reform and identify important ways to avoid unintended consequences.

Accreditation agencies face a clear conflict of interest when it comes to regulating colleges and universities: they are sustained with dues from the schools they regulate, and accreditation reviews are conducted by faculty from peer universities.

Modernize, but Don’t Expand, the Direct Federal Role. To highlight the limits of federal power is not to say that there is not a role for direct federal oversight of higher education investments. But policymakers should be mindful of which tasks the federal government is well suited to accomplish directly and which are better left to other actors. More specifically, policymakers should focus on bright-line tasks that the Department of Education is capable of effectively and transparently administering and that are most relevant to ensuring students and taxpayers are protected.

The Department of Education’s two primary oversight regulations—the CDR and 90/10 rule—should be replaced with two simple accountability mechanisms built around loan performance and designed to ensure that the worst actors are rooted out and that mediocre institutions feel pressure to improve. These tasks meet the bright-line standard because the data are readily available to the Department of Education, are a good indicator of the risk posed by various institutions to taxpayer and student interests, and can be transparently developed and implemented.

Establish a Performance Floor that Has Teeth. The most basic element of these new rules should be a performance floor under which institutions are no longer eligible to receive Title IV funds. This is very similar to the structure of the current CDR regulation, under which an institution will lose federal loan eligibility if its

three-year CDR rises above 40 percent in a given year, or will lose both its loan and Pell Grant eligibility if that rate exceeds 30 percent for three years in a row.³⁰

First, and most fundamentally, a performance floor should not be built around loan defaults, because students can enroll in forbearance to avoid defaulting even when they are not paying back their loans. As a result, colleges and universities can game the CDR rules, hiring default-management firms that specialize in helping students avoid default within the short-term measurement window.³¹ Defaults will become an even less-effective measurement as income-based repayment becomes more widely utilized.

A better option would be to use a measure of loan repayment rates. Such a measure would assess the proportion of students who are making progress in paying down their loan balance. This measure would be straightforward and readily understandable by all system participants. It would also hold institutions accountable for students who are taking advantage of existing repayment protections but are not in fact making progress in paying down the principal.

In future iterations, it would also be possible to measure different rates of progress. A measurement of the percentage change in a cohort's cumulative loan balance would be the most direct assessment of how a cohort of students is performing in repayment.

When it comes to setting standards, using a norm-referenced threshold could alleviate concerns about setting an arbitrary cutoff for a relatively new metric. By comparing institutions to national averages, such a policy would also reflect fluctuations in the economy that affect all providers. To start, institutions whose repayment rates were more than two standard deviations below the national median could be sanctioned. These reforms would be a big improvement over the current CDR.

In addition to deciding what to measure, policymakers should consider how many years a cohort needs to be in repayment before a school is held accountable for its performance. A performance floor is primarily designed to weed out institutions that are performing extremely poorly, so the imperative is to cut off access to federal funds sooner rather than later to protect students and taxpayers. Therefore, sticking with a three-year repayment window seems appropriate. Although

education is a long-term investment, it is still reasonable to expect that most of an institution's graduates will make some progress paying down their principal within three years.

Use Risk Sharing to Pressure Mediocre Institutions to Improve. The current CDR regulation is all or nothing.³² This means that mediocre colleges are deemed harmless so long as they stay below the CDR thresholds, which are quite forgiving. In other words, the vast majority of colleges have little skin in the game when their students default. Therefore, policymakers should add a risk-sharing mechanism that puts pressure on all institutions to improve.

The most important design question is how to structure penalties. Specifically, should penalties be applied as a flat percentage of all loans that are not being repaid? Or should the percentage increase be based on a sliding scale of performance such that the worst-performing institutions pay increasingly large penalties?

Imposing a flat percentage will put pressure on all institutions to improve loan repayment, even on those with fairly solid performance. This approach would reduce the likelihood that the average student defaults. Unfortunately, policymakers may be hesitant to impose penalties on relatively well-performing institutions.

Opting for a sliding scale will put more pressure on poor-performing institutions. In imposing a system of increasing penalties, however, policymakers must avoid large cliffs—specific repayment rates where the fraction of unpaid loan dollars a school must repay suddenly increases—so that institutions with very similar repayment rates do not face significantly different penalties. Failing to do this might invite gaming of repayment rates and potential legal challenges.

Policymakers should also consider using a longer time horizon for risk-sharing policies. Schools rightfully argue that the payoffs to educational investments do not accrue entirely within the first few years after graduation. Unlike a performance floor, which is focused on removing the worst-performing institutions quickly, a risk-sharing system is designed to change the incentives for institutions that remain in the market over time. A longer time horizon would provide a more comprehensive measure of performance.

Think about Rewards, Not Just Penalties. Policymakers must acknowledge the potential for unintended consequences of both the performance floor and risk-sharing policies. In isolation, schools will likely become more selective in admissions. That is not necessarily a bad thing, so long as schools can effectively sort applicants based on whether they will benefit from attending. More likely, though, colleges would use proxies such as income or zip code to make those decisions, potentially locking out students who would benefit from postsecondary education.

To balance this out, federal policy could award schools a bonus for every Pell Grant student they graduate, potentially using the proceeds from risk-sharing payments as a financing mechanism. These rewards would help mitigate the risk that hard-working, disadvantaged students' access to higher education would be harmed by these reforms.

Give Institutions Control over Accountability Measures. Policymakers should also consider giving institutions more control over the factors for which they are being held accountable, where feasible. For example, institutions cannot currently control how much their students are eligible to borrow in federal loans. In some cases, therefore, schools are held accountable for defaults that resulted from students borrowing well in excess of those institutions' tuition and fees. If we are going to hold institutions accountable for loan performance, policymakers should give them more discretion in placing limits on how much their students can borrow.

Delegate Responsibility, but to New Authorizers. While modernizing the direct federal role would be a step forward, federal power cannot on its own solve all of the problems previously laid out. Loan repayment metrics are too narrow a basis for fully determining program eligibility and, as a practical matter, not all institutions participate in the federal loan program. Moreover, the need to accommodate new entrants who have not had time to build a track record of success suggests an urgency for expert intermediaries who can take responsibility for certifying new providers.

Therefore, policymakers should maintain a role for nongovernmental entities in granting access to federal aid and ensuring quality. However, the current

approach, which delegates to accreditors, must be fundamentally reshaped.

Bring in New Actors. Some reform advocates argue that policymakers could address the failures of accreditation immediately by compelling accreditors to change their practices. For example, some advocates have proposed creating a tiered system of accreditation, both to make market entry easier and to lower the stakes of sanctioning an institution. Others have emphasized that accreditors need to focus on outcomes rather than inputs. And some argue that we must restructure how accreditors are paid for their services.³³

Policymakers should ask how the government can foster the emergence of alternative authorizers that are intentionally built to accomplish new goals and that have a vested interest in the supply of educated graduates.

Most of these proposals have merit and deserve consideration. However, they likely may not be enough to achieve the twin goals of ensuring quality and fostering innovation. More specifically, the problem with the existing system is not just how the delegation process has been structured and managed, but to whom the federal government has chosen to delegate.

Decades ago, policymakers tried to repurpose a set of organizations (accreditors), designed to do a different job in a different era, to take on an entirely new set of responsibilities. Because of their origins, staffing, and business models, these organizations are predisposed to sympathize with existing institutions and models and to be cautious about new ones. These realities will make it difficult for the current crop of accreditors to ever effectively provide quality assurance or be receptive to significantly different educational models.

Therefore, policymakers should ask how the government can foster the emergence of alternative authorizers—such as consortia of employers, non-profit groups, or professional associations—that are

intentionally built to accomplish new goals and that have a vested interest in the supply of educated graduates. This strategy takes a page from other sectors where so-called jurisdictional challenges have created space for new organizations to serve as an alternative to existing institutions.³⁴

In areas such as alternative teacher certification and charter schooling, policies have created parallel approval and licensure processes, allowing a new set of players into the market and providing evidence that alternative accountability regimes can work. Creating space for new authorizers of postsecondary options would create a credible alternative to the existing accreditation system.

One proposal along these lines is the *Higher Education Reform and Opportunity Act*, legislation sponsored by Senator Mike Lee (R-UT).³⁵ With the approval of the Department of Education, this bill would provide states the flexibility to approve new accreditors that could operate in their state with greater independence from the traditional higher education system.

Create a New Recognition Process Emphasizing New Goals. Currently, the Department of Education recognizes accreditation agencies through a formal recognition process. Critics have argued that this process mandates a focus on certain inputs, reinforcing accreditation's inherent conservatism.³⁶ Some reform proposals have called for the Department of Education to authorize new accreditors who would specifically focus on innovation.³⁷ But forcing them through the same recognition process might limit their latitude to think beyond the traditional college model.

The alternative path should feature a new recognition process that ensures that these incoming authorizers promote broad reform goals, including a focus on student outcomes and a flexibility that allows for innovation and new models. When it comes to the criteria by which authorizers evaluate educational providers, the new recognition process should call on authorizers to use outcome measures that are consistent with the goals of the programs they are assessing, such as direct assessments of student learning, increases in earnings potential, passage rates on relevant certification or licensure exams, and student satisfaction rates. Authorizers should also be required to disclose those outcomes to

the public. Additionally, authorizers should not be prohibited from considering inputs such as faculty credentials or facilities but should have the flexibility to choose which measures are important to ensuring the schools they oversee are meeting performance goals.

A new recognition process should also spell out different tiers of aid eligibility for programs authorized under this alternative path. Allowing for different approval tiers limits the risk to taxpayers when new, unproven models receive federal aid. It also allows for the approval of new institutions that have not yet had time to demonstrate the outcomes necessary for full eligibility.

A tiered process should also have some protections against fraudulent actors. For example, an institution that was provisionally approved might have its federal funds held in escrow until it begins to produce positive outcomes. Alternatively, or additionally, the institution's students might be eligible for smaller amounts of grant or loan dollars before the school becomes eligible for the standard program. New entrants would have to use startup capital to cover their expenses during this time, but they could at least raise private funding against the promise that they will receive student aid if their students perform well.

Give Authorizers Skin in the Game. New authorizers should furthermore be held accountable by the Department of Education for the performance of the portfolio of institutions they oversee. The department could assess authorizers not only based on existing loan performance metrics but on the specific outcome measures the entity pledged to use when it was recognized.

Authorizers would also be financially responsible for a portion of the delinquent loans that flow to the providers in their portfolio. Just as all colleges and universities would bear some of the risk of student failure under a new risk-sharing policy, so too would authorizers that were recognized via the alternative path.

For those providers that do not participate in the loan program, policymakers could put them on the hook for a percentage of public assistance (such as unemployment or welfare) that graduates receive.³⁸ If too many of the providers fail to provide a valuable education, the authorizer would no longer be financially viable. These potential financial repercussions

would give authorizers the incentive to be careful about who they certify and to be sure that they remove poor performers.

Such an arrangement would also mitigate the financial conflict of interest that currently exists between accreditors and institutions, where the latter finance the operations of the former. So long as authorizers bear some of the risk of student failure, they will have little incentive to approve providers simply to generate revenue.

Some might ask why it is necessary to create an alternative pathway for new authorizers at all, arguing that reformers should instead change the current recognition process for accreditors to incorporate the ideas previously outlined. While there is merit to that approach, policymakers must ensure that existing barriers that are baked into the existing recognition process—for example, the requirement that accreditors focus on inputs such as facilities, equipment, and curricula—are eliminated. They must also tighten up the accountability provisions that are part of that recognition process. However, doing so will likely be more politically challenging than building something new on green field.

Expand and Improve Market Accountability

While efforts to improve government-sponsored quality-assurance mechanisms are important, market discipline is essential to ensuring that colleges and universities provide an education that is worth its cost. Unfortunately, market accountability is not working as well as it should. In fact, proposals to expand government control over higher education are gaining traction precisely because the forces of market accountability are not doing enough to reward high-quality schools or put poor-performing ones out of business. So, what can we do about it?

Improve Market Transparency. Policymakers must work to improve the availability of information and tools that can help consumers discern the value of different educational products. The lowest-hanging fruit would be to improve transparency around student outcomes—such as graduation rates and expected earnings, broken out by program—so students and

parents have a better sense of which programs will best serve them. Existing proposals, such as the *Student Right to Know Before You Go Act* introduced by Senators Ron Wyden (D-OR) and Marco Rubio (R-FL), would make such data available.³⁹

It is important to note that data collection and transparency are areas where the federal government is poised to contribute substantially, far more than any other actor—public or private—in the system. This is particularly true when it comes to the kind of information that would be very valuable to prospective students who are about to make one of the biggest investments of their lives.

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For example, the federal government already has access to information on earnings and the postsecondary enrollment of the beneficiaries of student aid. Those data only need to be merged and made available in the aggregate to protect privacy. Without federal involvement, though, such information will not exist. In that sense, the information is akin to a public good.

Improving transparency is also in keeping with the traditional federal role in collecting data and making it public. Long before there was a Department of Education, the Office of Education was tasked with cataloging information on American schooling. Similarly, the private sector relies heavily on government data from the US Census Bureau and Bureau of Labor Statistics. Transparency is a core government service that delivers significant benefits to society, and reformers should embrace it in higher education.

Expand Private-Financing Tools that Can Guide Consumers to Value. Private-financing tools can also help guide students to institutions and programs that will serve them well. Income Share Agreements (ISAs) are one example, in which private investors pay the cost

of attendance in exchange for a percentage of students' future income over a fixed period of time.

Unlike a loan, ISAs have no principal balance, so students who are less successful after school will likely pay less than they received in financing. On the flip side, students who are more successful will repay the initial amount or potentially much more, though always with affordable payments.

Therefore, ISA investors have a strong incentive to help students find institutions that provide a return on investment and to provide them with support during and after their studies. Some ISA funders also tailor the terms of the contract depending on the expected economic value of an institution or program, sending students a clear signal about the value of different options.

While many entrants into the ISA market are still relatively new, they have struggled to grow and raise capital because existing law has not kept pace with these innovative financial products.⁴⁰ The *Investing in Student Success Act*, introduced by Senator Marco Rubio (R-FL) and Representative Tom Petri (R-WI), would help clarify consumer protections, tax treatment, and regulatory oversight to create a more vibrant market.⁴¹

By contrast, the federal loan program provides virtually unlimited access to subsidized credit that not only aids and abets poor investment decisions but also crowds out private-sector financing alternatives.⁴² Therefore, policymakers should put bounds around the federal program by repealing or capping PLUS loans. Putting borrowing limits in place would achieve the twin goals of allowing market-based financing options to grow while containing the ill-effects of giving consumers access to large amounts of loan capital with few questions asked.

Conclusion

Preserving a role for markets in higher education will give the system the flexibility and dynamism it needs to evolve with the 21st-century economy. At the same time, federal policymakers must expand and improve that role—with new tools to foster market accountability—to buttress an important component

of America's higher education quality-assurance system.

But the market cannot do it all. Even with better data, higher education is a difficult product to evaluate from the outside, leaving consumers vulnerable to aggressive marketing and recruitment. Given these challenges, the temptation is to simply substitute federal power for market accountability.

This would be a mistake. While we certainly see a role for the federal government in setting a performance floor and giving colleges some skin in the game, the federal government lacks both the capacity and the political will to make eligibility and accountability decisions from Washington.

Instead of moving away from the basic mechanisms of market discipline and a hands-off approach, policymakers should take steps to correct the flawed assumptions of past reformers about how those mechanisms would operate. That means thinking more broadly about who can guarantee academic quality, who bears the risk when students fail to pay back their loans, and how to equip consumers to more effectively vote with their feet. When combined, these reforms will help protect students and taxpayers while maximizing educational opportunity.

Notes

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