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ISSUE BRIEF



**RISK SHARING: HOW TO
HOLD COLLEGES
ACCOUNTABLE FOR THE
EDUCATION THEY PROVIDE**

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Executive Summary

College has become a risky proposition for students as well as taxpayers. Fewer than six in 10 students who start a degree will ever finish,¹ which means that they won't see a return on the money they've spent to attend—and if they took out a loan from the federal government, they might be left with unaffordable debt. In the latter case, the government's loan safety nets will bail them out. Colleges, it seems, are the only players who can't lose in the \$1.9 trillion-per-year business of higher education.²

There is a system in place to hold colleges accountable for the services they provide, but that system is failing students and taxpayers. This issue brief analyzes how the federal government can better measure college quality in order to police access to its student aid.

There are three recommendations:

- ✔ Use risk sharing to ensure that colleges compensate taxpayers for their students' use of the government's loan safety nets.

- ✔ Use a measure of the student loan repayment rate, rather than accreditation, to determine whether colleges are eligible for federal aid.

- ✔ Use targeted grants and scholarships to ensure that disadvantaged students can enroll in colleges that might otherwise be wary of these students' ability to repay their loans.



Why Hold Colleges Accountable?

The federal government is the single largest purchaser of postsecondary education services in the United States. The Department of Education, the Department of Veterans Affairs, and the Internal Revenue Service each pump billions of dollars every year into the booming higher-education marketplace in the form of grants, scholarships, interest-rate subsidies, debt forgiveness, and tax credits. The money is spent on behalf of students who attend colleges and universities. While student borrowers do pay attention to the quality of their own education, they can't be relied on to police the higher-education market with regard to cost relative to reward.

This is the appropriate role for the government that extended the dollars in the first place. More to the point of this paper, current federal law includes safety nets that allow student borrowers to have their debt forgiven if the amount they borrowed is unaffordable, based on their postcollege earnings. In essence, these safety nets mean that taxpayers are financing a guaranteed bailout when students attend colleges that don't deliver an education enabling them to earn enough to pay back the loans. This takes the pressure off the colleges to provide value while allowing them to benefit from rivers of cash.

The argument here is that some system of oversight needs to reapply that pressure. Colleges that accept federal student aid need a strong incentive to guide their students on a path to earnings that allow them to repay their debts. Students may forgive their college for letting them down when their loans are forgiven—but the federal government cannot.

Wanted: A Better Measure of Quality Control

The current system of oversight for colleges in the U.S. is implicitly based on the notion that the quality of education can and should be measured by examining the “inputs” rather than the “outputs.” The government largely relies on this system—accreditation—which grants access to federal student aid based on an evaluation of curriculum, faculty credentials, financial solvency, and available student services. There is no single standard; instead, dozens of accreditors make their money solely by selling accreditation to colleges. A college that doesn't pass the test with one accreditor has the option to seek out another. Colleges that pass these arbitrary tests for quality gain nearly unfettered access to federal Pell grants, student loans, tax credits, and veterans' scholarship benefits.³

Colleges that deliver consistently poor outcomes for their students, whether it be non-graduation, joblessness, or unaffordable loans, are penalized only with loss of access to aid dollars after they've shown, year after year, that a good number of their former students have found themselves in dire financial circumstances and unable to repay their loans.⁴ This bar is set too low.

Holding colleges accountable for the quality of education they provide their students isn't a controversial idea. But stakeholders—including colleges, policymakers, and student advocates—often disagree on exactly how to accomplish that task.

The returns to education are multidimensional. There are individual labor-market returns, which economists often focus on, but there are also social and individual returns that can't be measured in dollars. This means that all measures of quality will be subjective, based on individual preferences and perspectives. For example, a postsecondary program in fine arts might well be assessed as high quality by an artist who sees aptitude and knowledge in the program's graduates. The same program

might be assessed as low quality by an economist who notes that many of its talented students have defaulted on their loans. An uncontested, universal standard of quality is unattainable. Fortunately, policymakers don't need such a standard to settle on eligibility for federal aid dollars.

The federal government should not be in the business of sussing out and celebrating the ranks of good, better, and best colleges. Instead, it should aim to identify and levy punishment on the ranks of bad, worse, and unacceptable colleges. There may be no agreement on what makes a college great. But there can be agreement that, at least when it comes to the matter of where to extend billions of taxpayer dollars, colleges that release their graduates into the world without the capacity to repay their education debts are falling short. Access to this money should be a privilege afforded only to colleges that can demonstrate, in this narrow sense, that they are sending their students into the world with the tools to succeed. A college that failed to meet this standard would not be shut down by the federal government—but it would lose access to federal aid. All colleges would be free to operate with access to higher-education finance in the private market. This philosophy on college quality and the federal role narrows the field of relevant quality metrics to just a few.

Metrics of Quality

The only current financial outcome used to assess the quality of institutions that are eligible for federal aid is the cohort default rate. According to the Office of Federal Student Aid, this metric is the percentage of a school's borrowers who enter repayment during a federal fiscal year and default prior to the end of the second following fiscal year.⁵

While the cohort default rate is designed to capture the ability of graduates to repay their debts, it falls short because colleges manipulate repayment statistics by encouraging students to enroll in programs that postpone repayment.⁶ Student borrowers can use a variety of tactics to avoid having their loan enter default while still failing to make any progress in paying down their balance.

A 2015 report from the Brookings Institution showed that the cohort default rate failed to reveal variation across colleges in how much students were succeeding in paying down their debt and offered, for the first time, an alternative metric: the loan repayment rate.⁷ This measures the percentage of borrowers who succeed in lowering their *loan balance* over a given period of time. The advantage of this metric is that it reveals when borrowers don't make progress in paying down their loans because they are eligible for programs that postpone payments without causing their loan to be reported as delinquent.

There is another way to measure the quality of a college's education: tally the total economic cost of the institution's participation in the federal student loan program. Colleges and their student borrowers can take advantage of interest-rate subsidies, default, extended repayment, and non-repayment due to eligibility for loan forgiveness. Measuring the overall cost of a college's engagement with the federal student loan program offers an alternative for setting sanctions, or limiting aid eligibility, that would align the incentives of colleges with those of taxpayers.

Risk Sharing: A Better Way to Hold Colleges Accountable

In recent years, many in Congress, led by Senator Lamar Alexander of Tennessee, have begun to explore "risk sharing" as a device to police educational institutions' access to federal student loans. Risk sharing would put colleges on the hook financially when students face bad economic outcomes, such as an inability to repay their loans. Though risk sharing is often thought of as a supplement to the current accountability regime based on accreditation and cohort default rates, Congress would do better to pursue a more streamlined approach.

Such a streamlined approach would levy sanctions on colleges to recoup the cost imposed on taxpayers when their students use loan safety nets, such as income-based repayments and need-based loan forgiveness.⁸ Colleges would be required to remit payments to the U.S. Department of Education that are equivalent to, or proportional to, the economic cost that their students impose on taxpayers through the system of loan safety nets. And colleges would be assessed such payments, or penalties, *annually*, to maximize the incentives of institutions to get their house in order. The penalties would be based on the future costs that their students' loan safety nets would impose on taxpayers—such costs to be based on an assessment of students' outstanding loan portfolio.⁹

Moreover, and more important, this risk-sharing regime should not operate independently of the system that determines an educational institution's eligibility to receive federal aid dollars. Colleges that continually send students into the world with federal student debts that they cannot afford to repay should not only be sanctioned financially but should lose access to federal financial-aid dollars. This approach would align the incentives of colleges and universities with taxpayers as well as students. The benefits are obvious: taxpayers are clearly better off when colleges minimize losses imposed on them by unaffordable student debt; and students, who *overwhelmingly report financial and career aspirations as their primary motivation for enrolling in college*, will be better served by institutions that have an explicit motive to help students achieve their aspirations.¹⁰

Implementing such a system would require further analysis to determine how to set the thresholds for an institution's eligibility for federal student aid, based on the loan repayment rate or, as I would advocate, the total economic reliance on loan safety nets. Policymakers should also consider a nonbinary eligibility scheme: one in which better-performing colleges have the most access to aid dollars and worse-performing colleges have access to less.

An accountability regime of the kind recommended here could be massively disruptive to higher education. It would, therefore, likely need to be implemented incrementally over a number of years to allow colleges to adjust their business models to comply with the new incentives.

Ultimately, a comprehensive, outcome-based accountability system could replace accreditation as the gatekeeper to federal aid dollars. To be sure, there would need to be standards for new colleges, with no record of performance, that sought access to aid. One conservative approach would be to require these institutions to operate and remain financially solvent without access to federal student-aid dollars before they could be declared eligible. This requirement would also provide an avenue for colleges to regain access to federal student-aid dollars after losing eligibility.

Implications of Risk Sharing for Student Opportunity

Discussions about holding colleges accountable based on their students' outcomes often run up against a major criticism: colleges serving disadvantaged and minority students would be the first to face sanctions. This is not because these institutions add less value than others but rather because the students who attend these schools would likely have financial challenges after graduation regardless of where they enrolled. For example, a Brookings Institution study showed that bachelor's degrees yielded a lower rate of return for poorer students even when compared only with wealthier students.¹¹ Sanctions based on an outcome-based accountability policy would almost certainly be levied disproportionately against colleges serving already-disadvantaged students.

This objection is well-meaning. After all, significant efforts in both private and public spheres have gone into ensuring that a broader set of young people have access to college-level education. Penalizing institutions that serve these students would cut against these efforts.

However, educators, policymakers, and the general public need to keep in mind that college is a means to an end. Access to a college education that doesn't pay financial dividends is simply access to unaffordable debt. Penalizing colleges that serve disadvantaged populations through sanctions or reduced access to federal aid may result in less enrollment—but students who borrow to pay for degrees that lead to earnings that won't even allow them to repay their loans will often be left worse off than if they hadn't enrolled in the first place.

Unfortunately, some analysts have proposed that colleges serving disadvantaged populations should get a pass on the standards of quality that are in place for other institutions.¹² The rationale here is that propping up colleges that serve disadvantaged students at least gives these people a chance at a postsecondary education. But these efforts would be misguided, since they could result only in allowing vulnerable young people to start down a path that has proved to be hazardous for others who have gone before them.

Instead, expanding opportunities for students from poor or disadvantaged families to attend college would be better achieved through direct subsidies. That might mean delivering much larger Pell grants to less well-off students or creating a new scholarship to support students from disadvantaged communities. Those dollars would reduce the need for those students to borrow, which would make them viable candidates for colleges that are wary of admitting students who might have trouble repaying their loans. This proposal could generate tremendous savings over the current system of student aid.

Conditioning an institution's eligibility for federal student loans based on student outcomes, particularly through risk sharing, would result in a more efficient and transparent use of taxpayer dollars. It would also provide a strong incentive for colleges to provide a quality, relevant education for students seeking to better their future prospects.

Endnotes

- ¹ Elissa Nadworny, "College Completion Rates Are Up, but the Numbers Will Still Surprise You," NPR, Mar. 13, 2019.
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- ³ For a detailed discussion of the theory, history, and practice of accreditation, see Robert Kelchen, *Higher Education Accountability* (Baltimore: Johns Hopkins University Press, 2018).
- ⁴ The shortcomings of the existing rules for eligibility are discussed in Michael Itzkowitz, "Why the Cohort Default Rate Is Insufficient," *Third Way*, Nov. 7, 2017.
- ⁵ U.S. Department of Education, Office of Federal Student Aid, "Official Cohort Default Rates for Schools," Sept. 30, 2019.
- ⁶ Borrowers unable to afford their loan payments because of low earnings can postpone repayment without entering default or delinquency by enrolling in income-based repayment programs that set monthly payments to an affordable fraction of earnings, which is sometimes zero.
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- ⁹ Such an assessment would require the Department of Education to link earnings records from the IRS to data on borrowing from its own data system.
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