Why Doesn't "Gainful Employment" Apply to All Types of Colleges?

Some people refer to *public, nonprofit*, and *for-profit* as a college's "tax status." But that is misleading. The monikers refer to the legal requirements for how the institutions operate and who they are accountable to, not to how they are treated in tax laws. Investors have much more freedom and control as for-profit owners than if they were to invest the same amount in the form of a loan to a nonprofit or public institution. In choosing to operate as a for-profit, a college is *choosing less regulation*. The differences are summarized below.

	Public	Nonprofit	For-profit
Who is responsible for governing the institutions, including setting tuition rates and budgets?	Elected and appointed state officials	Trustees	Owners
What are they allowed to spend money on?	Education or another public purpose	Education or a charitable purpose[1]	Anything, including distributions of profit for owners
Can top-level decision-makers personally profit from the operations of the institution?	Generally no	Generally no[2]	Yes
Do colleges have access to equity markets to invest and expand?	No	No	Yes
Is there a financial backstop if something goes wrong and the college is bankrupt?	Taxpayers	No	No

When for-profit schools sought more access to federal aid, Congress included a condition: schools could have the weaker regulations that come with for-profit control, but only *if* the federal funding was tied to a goal that could be monitored: ***preparing students for <u>gainful employment</u> in a recognized occupation***. Congress also required schools to show they are charging a fair market price by having some customers without federal aid (the so-called 90/10 rule).

Congress can change these requirements, but should beware: whenever oversight of for-profit colleges has been reduced, the result has been rampant abuses of students and a scandalous waste of taxpayer funds.[3]

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[1] Unrelated business operations are taxed, and if excessive can jeopardize the tax-exempt status of the organization.
[2] Private inurement is prohibited, trustees are generally not paid, and employee compensation must be reasonable.
[3] See The Century Foundation's four-part series, The "Cycle of Scandal," at https://tcf.org/topics/education/the-cycle-of-scandal-at-for-profit-colleges/

Why does federal financial aid not cause the same types of abuses at public and nonprofit colleges? Two excerpts from economists provide useful context:

> *"Profit is one of the most potent incentives known to man—a powerful tool to align managers' interests with corporate goals. But it also has drawbacks. With earnings as the overriding, nonnegotiable priority, private enterprise often has little wiggle room to handle the tension between conflicting objectives. . .*
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> *"This suggests a good rule of thumb to determine when a private company will outperform the public sector: if the task is clear-cut and it's possible to define concrete goals and reward those who meet them, the private sector will probably do better.*
>
> *"But if the objectives are complex and diffuse—making it difficult to align profit with goals without undermining some other desirable outcome—the profit motive could well make conflicts more difficult to manage."*
>
> Eduardo Porter, economics columnist[4]

> *In markets where customers are little informed about what they are buying, they can easily be taken advantage of—at the extreme, consumers may not be informed about whether they have bought anything at all. Did the CARE package get delivered in Somalia? Was the contribution to public radio actually used to support programs? More often, consumers know that they have bought something, but they also know that they are vulnerable to receiving a service of lower cost and quality than they expected and paid for. Given the asymmetries of information, though, it may be impossible to draw up a contract that guarantees that the expected quality in all its dimensions will be provided. As a result, nonprofits are frequently found in the markets for things like nursing homes, day care and education.*
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> *Markets like these are sometimes referred to as "trust markets" because of that vulnerability.* ***The nonprofit structure of suppliers encourages the honest if profit-sacrificing behavior that justifies trust****. By reducing incentives for the opportunistic behavior, nonprofits become the preferred suppliers in certain settings: they increase the probability—and the confidence of donors or buyers—that they're getting what they are paying for, tending to offset the contract failure inherent in such asymmetric markets. . .*
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> *[The point] is not that the nonprofit form is without its own set of issues or problems, but rather that the non-distribution constraint [the prohibition on distributing profits] serves to soften the incentive that a for-profit supplier has to take advantage of the partially informed buyer.*
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> Gordon C. Winston, economist[5]

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[4] "When Public Outperforms Private in Services" *The New York Times*, January 16, 2013, http://www.nytimes.com/2013/01/16/business/when-privatization-works-and-why-it-doesnt-always.html?pagewanted=all

[5] Gordon C. Winston, "Subsidies, Hierarchy and Peers: The Awkward Economics of Higher Education," *Journal of Economic Perspectives* 13 (1) (1999): 13–36.