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## The Regulation of Student Financial Aid: Who Bears What Costs Matters Most

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# ESSAY

## THE REGULATION OF STUDENT FINANCIAL AID: WHO BEARS WHAT COSTS MATTERS MOST

*Andrew B. Whitford\* & Janet S. Whitford\*\**

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### I. INTRODUCTION

At the beginning of the second decade of the 2000s, growing attention to issues in the financial aid regulatory space caused governments and interest groups to call for enhanced regulation of for-profit, public, and private educational institutions. Three notable reports from the U.S. Government Accountability Office (GAO) pointed to substantial worries about the ability and willingness of providers in higher education markets to convince students to take on substantial debt in the pursuit of degrees.<sup>1</sup>

For instance, in the case of proprietary schools, the GAO noted:

Students are required to pass a test of basic math and English skills

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1. Three reports form the auditing core of the federal government's recent policy attempts to expand regulation in this arena. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-600, PROPRIETARY SCHOOLS: STRONGER DEPARTMENT OF EDUCATION OVERSIGHT NEEDED TO HELP ENSURE ONLY ELIGIBLE STUDENTS RECEIVE FEDERAL STUDENT AID (2009) [hereinafter GAO-09-600, PROPRIETARY SCHOOLS]; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-948T, FOR-PROFIT COLLEGES: UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES (2010) [hereinafter GAO-10-948T, FOR-PROFIT COLLEGES]; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-10, HIGHER EDUCATION: STRONGER FEDERAL OVERSIGHT NEEDED TO ENFORCE BAN ON INCENTIVE PAYMENTS TO SCHOOL RECRUITERS (2010) [hereinafter GAO-11-10, HIGHER EDUCATION].

or have a high school diploma or GED to qualify for federal student aid. Yet, GAO and others have found violations of these requirements. For example, when GAO analysts posing as prospective students took the basic skills test at a local proprietary school, the independent test administrator gave out answers to some of the test questions. In addition, the analysts' test forms were tampered with—their actual answers were crossed out and changed—to ensure the individuals passed the test.<sup>2</sup>

In the case of an investigation of for-profit colleges, the GAO noted:

Undercover tests at 15 for-profit colleges found that 4 colleges encouraged fraudulent practices and that all 15 made deceptive or otherwise questionable statements to GAO's undercover applicants. Four undercover applicants were encouraged by college personnel to falsify their financial aid forms to qualify for federal aid—for example, one admissions representative told an applicant to fraudulently remove \$250,000 in savings. Other college representatives exaggerated undercover applicants' potential salary after graduation and failed to provide clear information about the college's program duration, costs, or graduation rate despite federal regulations requiring them to do so.<sup>3</sup>

More generally, following an earlier study of the proliferation of incentive compensation for student recruiters, the GAO pointed its finger squarely at the U.S. Department of Education (ED) for failures in its oversight of such programs across a wide array of higher education organizations.<sup>4</sup> The GAO explained that while “[e]ducation has processes to monitor schools for potential violations, [] its methods to detect violations and track monitoring activities are limited,” and that substantial changes were needed “to strengthen Education’s monitoring and enforcement of the incentive compensation ban and to help protect

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2. GAO-09-600, PROPRIETARY SCHOOLS, *supra* note 1. More developed discussion of this point follows in the report. *Id.* at 22–25.

3. GAO-10-948T, FOR-PROFIT COLLEGES, *supra* note 1. Deeper discussion of this general issue follows in the report. *Id.* at 4. Note that GAO inquired about one degree program at each college. *Id.* at 2. Each college was given a fictitious student with the characteristics of “low income/assets;” this student would qualify for federal loans and/or grants. *Id.* at 2–3. The college was also given a fictitious student with the characteristics of “high income/assets;” this student would only qualify for unsubsidized loans. *Id.* Majors included in such “experiments” included cosmetology, construction management, and elementary education. *Id.* at 2. Those engaging in deceptive practices were referred to regulatory authorities. *Id.* at 4.

4. GAO-11-10, Higher Education, *supra* note 1, at 2, 4.

students and the federal investment in their education.”<sup>5</sup>

The problems of higher education and financial aid are widely discussed in the popular press, and for good reason: the U.S. federal government holds a roughly \$1.4 trillion student-loan debt portfolio,<sup>6</sup> and while some movement has occurred with regard to debt forgiveness and loosening the rules about debt discharge through bankruptcy,<sup>7</sup> the federal government has substantial issues in simply estimating the size of that portfolio and the potential impact of proposed forgiveness programs.<sup>8</sup>

The purpose of this Essay is to consider the general problem of the regulation of student financial aid, and its implementation via networks of higher education organizations in concert with public and private lenders, from the lens of “regulatory burden.” It has become fashionable to speak of the procedures for joint implementation of this system in terms of burden. For example, a 2013 study from the National Association of Student Financial Aid Administrators (NASFAA), entitled “Getting It Right: Analyzing the Accuracy of Federal Burden Estimates for Title IV Financial Aid Compliance,” described the situation as one-sided.<sup>9</sup> In their view:

Greater transparency from the Department of Education would allow for a more detailed understanding of how burden estimates are calculated. It would also form a solid basis for constructive dialogue on how to ensure that estimates reflect, with more representative accuracy, the effort that school financial aid offices must undertake for the purpose of compliance.<sup>10</sup>

The problem, of course, is that one person’s “regulatory burden” is another person’s “protection against predatory market practices.” Historically, regulation has sought to balance competing goods. On one hand, markets are powerful mechanisms for assembling and using

5. *Id.*

6. OFF. OF FED. STUDENT AID, U.S. DEP’T OF EDUC., FEDERAL STUDENT LOAN PORTFOLIO, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio> (providing the Federal Student Aid Portfolio Summary of the current student-loan debt).

7. *See, e.g.*, Josh Mitchell, *White House Floats Bankruptcy Process for Some Student Debt*, WALL ST. J. (Mar. 10, 2015, 8:18 PM), <https://www.wsj.com/articles/white-house-studying-new-bankruptcy-options-for-student-loan-borrowers-1426004272>.

8. *See, e.g.*, Josh Mitchell & Andrea Fuller, *U.S. Eyes Big Data on Student Debt*, WALL ST. J. (Mar. 20, 2015, 6:33 PM), <http://www.wsj.com/articles/u-s-eyes-big-data-on-student-debt-1426890836>.

9. NAT’L ASS’N OF STUDENT FIN. AID ADM’RS, GETTING IT RIGHT: ANALYZING THE ACCURACY OF FEDERAL BURDEN ESTIMATES FOR TITLE IV FINANCIAL AID COMPLIANCE (2013) [hereinafter NASFAA].

10. *Id.* at 7. Of course, key considerations in such settings include decision points in calculating burden, formulas, levels of transparency, and whether components of the burden estimation formula are concealed. *Id.*

resources to provide goods and services demanded by the public. On the other hand, given market imperfections, citizens often demand that governments protect people from market actors that use those imperfections for their own benefit. In the case of student financial aid, though, this balancing act is complicated by the unique role of the federal government as a large provider of financial assistance to students.

Effectively, in many cases, the federal government has become almost a monopolistic purchaser of education for students, although, in the end, students are ultimately responsible for repaying government loans and other debt incurred in the search for educational attainment.

We begin this Essay with a review of the development of regulatory burden as a general problem in the relationship between states and markets. Following that, we offer the financial aid policy space as a special regulatory environment, and consider the general structure of that space given the typical treatment of regulation in our understanding of business-government relations. In that section, we review the types of evidence that exist about the financial aid regulatory environment, and then provide evidence on regulatory burden as a general problem in this area. We also consider the possibility that higher education's market segments are differentially regulated—that some segments are over-regulated, and others are under-regulated. Finally, in the last section, we reflect on the problem of interpreting and managing regulatory burden in higher education markets, with special attention to the question of whether differential regulation changes the incentives of different market actors.

## II. THE CURIOUS CONCEPT OF REGULATORY BURDEN

In this Part, we briefly review the theory of regulation to introduce regulatory burden as a core concept in assessing the evidence about the student financial aid regulatory environment in the United States.

Our starting point is the claim that the higher education system is a compilation of markets of varying shapes, sizes, and constructions. This claim is not immune to critique, for many have argued that this evolution—this “restructuring [of] higher education as a market rather than a regulated public sector”<sup>11</sup>—is a new competitive environment. Yet in important ways, those who have focused on this institutional change in our organizational arrangements for providing higher education have missed the point of these changes. One way this change has been characterized is that “[t]he result is an evolution of the higher education

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11. FRANK NEWMAN ET AL., *THE FUTURE OF HIGHER EDUCATION: RHETORIC, REALITY, AND THE RISKS OF THE MARKET*, at xi (2004). While such restructuring has occurred over long periods of time, this report gives special attention to more recent structural changes.

sector toward operating far more as a market, with universities and colleges competing to supply the service of education, as opposed to the concept of higher education as a public sector structured principally by government regulation.”<sup>12</sup> The upshot of this view is that while “in the old world, government would tend to depend on regulations to control costs,” now government relies on competition.<sup>13</sup>

In important ways, this view is naïve about the role of regulation in sustaining markets. A more nuanced view is that regulation is fundamental to the functioning of all markets, that forces outside market actors to shape competition both in the short- and long-term, and that all market actors have incentives to shape that competitive environment to benefit their own competitive positions. This view is well-described by David Baron in his book *Business and Its Environment*.<sup>14</sup>

Baron summarizes it in this way:

The causes of these problems are frequently found not in a company’s market environment but instead in forces outside its markets. Indeed, for many companies, market success depends not just on their products and services, the efficiency of their operations, their internal organization, and the organization of their supply chains, distribution channels, and alliance networks. Success also depends on how effectively they deal with governments, interest groups, activists, and the public. The forces these parties generate can foreclose entry into new markets, limit price increases, and raise the costs of competing. They can also unlock markets, reduce regulation, handicap rivals, and generate competitive advantage.<sup>15</sup>

The focus for all managers of organizations in this space, then, is to integrate the organization’s “non-market strategy” with its market strategies. In Baron’s view, though, managers historically have ignored the former and mostly focused on the latter.<sup>16</sup>

Inevitably this focus leads to a consideration of how market actors seek to “write the rules of the game” to benefit their organization in these markets—even to the point in many cases of shaping the creation of new markets. This view fits with perspectives on regulation that developed over the latter half of the twentieth century.

Helm offers a useful (though simplified) discussion of a broad swath

12. *Id.* at 2.

13. *Id.*

14. DAVID P. BARON, *BUSINESS AND ITS ENVIRONMENT* (7th ed. 2012).

15. David P. Baron, *The Nonmarket Strategy System*, 37 SLOAN MGMT. REV. 73, 73 (Fall 1995).

16. *See generally id.*

of findings about regulation in a political economy—one that centers on regulatory burden as a core measuring stick for the quality of regulation.<sup>17</sup> In his view, the first question is whether a broad theoretical case can be made that existing regulations are excessive; the second is whether empirical evidence exists that the level of regulation lowers economic performance.<sup>18</sup> Once those questions have been answered, designers should address when there should be regulation (the “optimal” level) and then, based on that level, the form it should take.<sup>19</sup>

Once regulation has been decided, the attention shifts to addressing the different costs of regulation. Because there are different kinds of regulation, and because regulation is heterogeneous in its effects on different market actors, economists want to measure regulation’s allocative effects (such as how it shapes decisions to allocate resources or invest in new markets) and its administrative burden.<sup>20</sup> For Helm, “[w]hile the policy debate tends to focus on the administrative burden, it is the allocative effects that are likely to be the most important for economic performance.”<sup>21</sup>

Allocative effects are fundamental because they are shaped by the strategies of market actors. Consider an actor that will benefit from enhanced regulation. How might that occur? Just as consumers can demand regulation, so can producers. Helm elaborates on three ways producers might benefit from regulation that are particularly important in higher education markets: “to protect sunk costs in natural monopoly; to promote R&D and innovation; and to enhance (or limit) competition.”<sup>22</sup> Once firms seek regulation for protection’s sake, the polity is required to regulate that concentrated market with regard to competition, monopoly, and other antitrust considerations.

The problem for economists is how the supply of regulation responds to such demand. Politics produce regulation in response, and the argument is often made that such regulation is over-supplied relative to the optimal level for competitive markets. Responsive politicians may become “captured” by regulated entities, so institutional designers shift to the mechanisms that supply regulation to create better incentives for that supply. Such solutions center on delegation of the regulatory function to independent agencies that rely on professionalized expertise to decide

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17. See, e.g., Dieter Helm, *Regulatory Reform, Capture, and the Regulatory Burden*, 22 OXFORD REV. ECON. POL’Y. 169 (2006).

18. *Id.* at 170.

19. *Id.*

20. *Id.* at 172.

21. *Id.* (explaining that allocative effects are ways of considering the impact of economic changes on both the structure of markets but also their heterogeneous effects on the decisions of consumers and producers).

22. *Id.* at 173.

the right supply and its administration.<sup>23</sup> Even though most arrangements are “second-best” (at best), there are worse institutional arrangements for designing the regulatory environment—most often, by politicians with short-term incentives to over- or under-regulate.

The problem with assessing regulatory burden in such systems is that it depends on so many factors. A simple distinction is: “burden for whom.” Does the regulator or the regulated entity carry (on average) the greater burden of regulation? Another distinction is whether the burden is “justifiable”—that is, given the purposes of regulation, is the average burden too high to justify seeking those benefits? Put another way, do the costs of regulation outweigh the expected benefits? Or alternatively, is the burden high for some market entities and not for others—and is that differential burden justifiable given the purposes of regulation?

One clearly sees the positive and normative implications of these theoretical claims. On one hand, these positive claims about regulation suggest that not all regulation is created for the purpose of benefiting society as a whole, and that regulated entities see benefits from being involved in shaping, and indeed in pursuing, regulation. At the same time, as Baron notes above, these views have normative implications: that regulated entities should become involved in regulation and that some entities should seek (for their own benefit) increased regulation as a way of constructing market barriers to entry (or at least in increasing the costs of doing business and shifting the marginal cost curve for other, less competitive organizations).<sup>24</sup>

Indeed, at a minimum, consumers should use regulation to shape the costs of production and thus change market prices, although whether they should pursue *increases* or *decreases* in regulation is itself an empirical question (depending on the relative thickness of supply in markets, whether they individually benefit from reduced access to education by their own competitors in the labor market, etc.).

The upshot of this discussion is that regulatory burden is a loaded term. We can speak of regulation’s benefits, though we want to be exact about who receives those benefits since it might include both consumers and producers. We can speak of regulation’s costs (though, again, exactness is important because both producers and consumers—in addition to regulators—pay the costs of regulation). In contrast to more neutral terms like benefit and cost, burden has a valence. Burden has an intrinsic aversiveness—a negative valence—because it neglects the benefits side of the equation entirely.

One main claim in this paper is that discussions about the regulatory

23. See GARY J. MILLER & ANDREW B. WHITFORD, ABOVE POLITICS: BUREAUCRATIC DISCRETION AND CREDIBLE COMMITMENT, 141–67 (2016).

24. See generally Baron, *supra* note 15.



environment for student financial aid have been cast (unfortunately) in terms of the regulatory burden of the suppliers of education. There has been little systematic discussion of the various benefits that are distributed to various groups by the institutional design of that regulatory environment. The emphasis has focused largely on the costs (both compliance costs and obligations due to perceived “red tape”<sup>25</sup>) carried by schools that mediate the relationship between the student requesting financial aid to pay for college, and the lender (mostly backstopped by the federal government) who supplies that financing.

Red tape is now an elemental concept in our conversations about the rule-bound nature of policymaking and the administration of programs in large, complex bureaus.<sup>26</sup> Likewise, studies of regulation have focused on compliance costs—located outside the regulator, and borne largely by regulated entities—as an elemental concern in the role of governments in shaping the incentives of firms.<sup>27</sup> The devil is in the details for both concepts though: what is the best measure of “red tape” or “compliance costs” that is reliable and divorced from the interests of the regulated entity?

In the next Part, we move this conversation forward by considering the evolution of this discussion to center on the regulatory burden perceived by providers of education and training.

### III. TYPES OF EVIDENCE ABOUT FINANCIAL AID REGULATION

Surprisingly little research attention has been devoted to the regulatory environment of student financial aid. For instance, Cheit noted in 1977 that federal regulatory oversight was increasing and that educational institutions perceived increases in the burden of regulation.<sup>28</sup> By the 1990s, researchers focused largely on the continuing lack of clarity for determining aid eligibility,<sup>29</sup> and appreciation of the growing need for regulation, but also wariness about the correct form.<sup>30</sup> There was also a

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25. E.g., Barry Bozeman, *A Theory of Government “Red Tape,”* 3 J. PUB. ADMIN. RES. & THEORY 273, 274 (1993).

26. E.g., *id.* at 278–79.

27. See, e.g., Dorothy M. Daley et al., *Checks, Balances, and the Cost of Regulation: Evidence from the American States*, 60 POL. RES. Q. 696, 696 (2007); Julian R. Franks et al., *The Direct and Compliance Costs of Financial Regulation*, 21 J. BANKING & FIN. 1547, 1547 (1997).

28. Earl F. Cheit, *The Benefits and Burdens of Federal Financing Assistance to Higher Education*, 67 AM. ECON. REV. 90, 90–91 (1977). We could debate about whether regulation was “creeping” or in response to a particular event, but the main point remains that 1977 was a key point of departure for higher education markets. See *id.*

29. E.g., Thomas Flint, *Historical Notes on Regulation in the Federal Student Assistance Programs*, 21 J. STUDENT FIN. AID 33, 37 (1991).

30. E.g., Robert Pernell Huff, *An Analysis of the Regulation of Federal Student Financial*

growing sense of the political fragmentation of post-secondary education (especially with regard to the passage of the Higher Education Act (HEA) of 1992).<sup>31</sup> After 2000, researchers and commentators focused directly on the role of the HEA and its reauthorization as shaping the balance between the benefits and costs of regulation.<sup>32</sup> Notably, in a working paper, Cellini and Goldin provide evidence that institutional designs allowed access to Title IV funding influenced prices—for-profit schools with access to such funding charge tuition prices that are substantially higher than those without access.<sup>33</sup>

In contrast, there has been substantial discussion of the consequences of that environment for borrowers, with much of that attention being placed on the role of for-profit institutions.<sup>34</sup> Indeed, the data in Figure 1 show the count of investigative reports, reported by the ED Office of Inspector General (OIG), which we consider related to the regulation of access to financial aid.<sup>35</sup> We recognize some uncertainty in coding such events (with regard to the contribution of financial aid to the case, compared to other considerations and sources of fault, or with regard to the type of organization involved), but the trend in OIG attention to financial aid is fairly clear. From 1999 to 2014, the number of events has grown almost every year. Even if we account for volatility in the time

*Aid*, 25 J. STUDENT FIN. AID 5, 11–13 (1995).

31. See Susan B. Hannah, *The Higher Education Act of 1992: Skills, Constraints, and the Politics of Higher Education*, 67 J. HIGHER EDUC. 498, 498 (1996).

32. E.g., REBECCA R. SKINNER, CONG. RESEARCH SERV., RL33909, INSTITUTIONAL ELIGIBILITY FOR PARTICIPATION IN TITLE IV STUDENT AID PROGRAMS UNDER THE HIGHER EDUCATION ACT: BACKGROUND AND REAUTHORIZATION ISSUES (2007); LINDSEY BURKE, THE HERITAGE FOUND., REAUTHORIZING THE HIGHER EDUCATION ACT—TOWARD POLICIES THAT INCREASE ACCESS AND LOWER COSTS (2014), <http://www.heritage.org/education/report/reauthorizing-the-higher-education-act-toward-policies-increase-access-and-lower>; Robin L. Capt, *Analysis of the Higher Education Act Reauthorizations: Financial Aid Policy Influencing College Access and Choice*, 3 ADMIN. ISSUES J. 1, 16 (Oct. 2013).

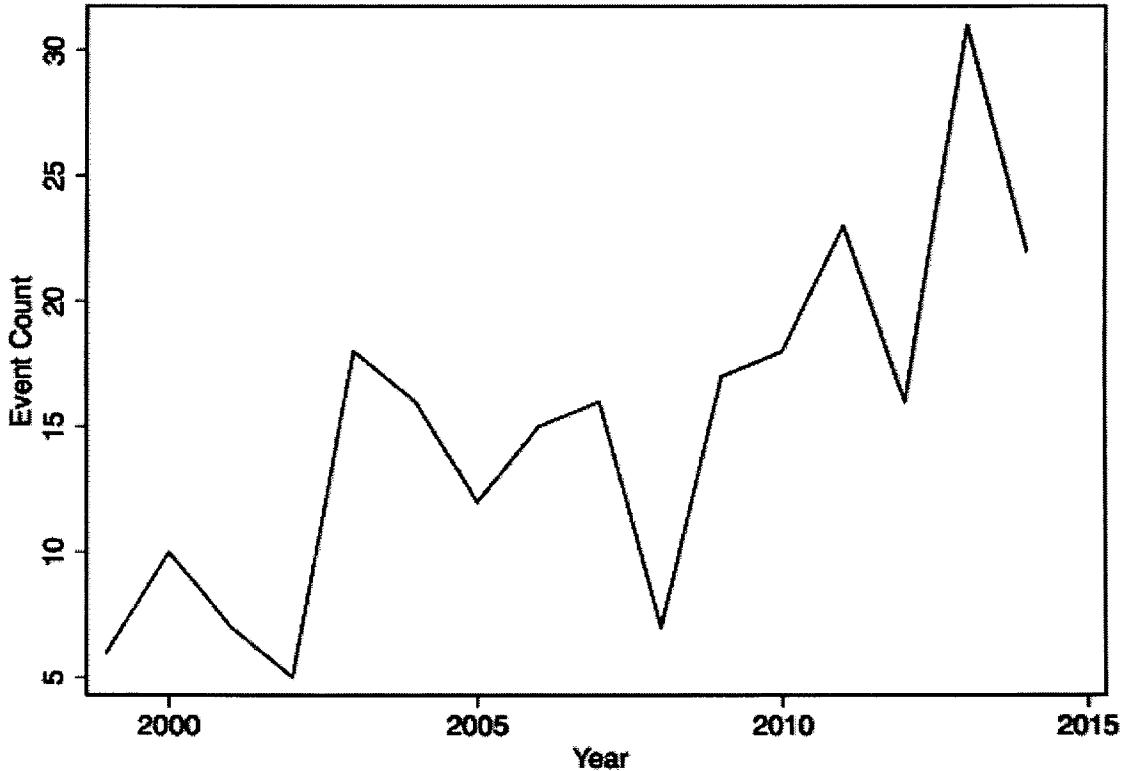
33. Stephanie Riegg Cellini & Claudia Goldin, *Does Federal Student Aid Raise Tuition? New Evidence on For-Profit Colleges*, 6 AM. ECON. J.: ECON. POL'Y 174, 201 (2014) (providing a substantial example of the use of new statistical methods for the assessment of these questions about higher education markets). See Eduardo Porter, *The Bane and the Boon of For-Profit Colleges*, N.Y. TIMES (Feb. 25, 2014), <http://www.nytimes.com/2014/02/26/business/economy/the-bane-and-the-boon-of-for-profit-colleges.html>.

34. E.g., Katherine Mangan, *Enrollments Slipped This Fall, With For-Profit Sector Hit Hardest*, THE CHRON. OF HIGHER EDUC. (Dec. 12, 2013), <http://www.chronicle.com/article/Enrollments-Slipped-This-Fall/143573/>; Eduardo Porter, *The Bane and the Boon of For-Profit Colleges*, N.Y. TIMES (Feb. 25, 2014), <http://www.nytimes.com/2014/02/26/business/economy/the-bane-and-the-boon-of-for-profit-colleges.html>; *Monsters in the Making?*, ECONOMIST (July 22, 2010), <http://www.economist.com/node/16643333>; *Schools of Hard Knocks*, ECONOMIST (Sept. 9, 2010), <http://www.economist.com/node/16990955>.

35. For underlying data see ED OFFICE OF INSPECTOR GEN., U.S. DEP'T OF EDUC. (last updated Sept. 15, 2017), <http://www2.ed.gov/about/offices/list/oig/ireports.html>. The data was gathered and coded in February 2015.

series, there is a substantial structural break in the data around 2010, with greater numbers of events after that year. Unfortunately, the nature of the reports makes it impossible to draw any conclusions about the relative incidence of such enforcement actions across institutional types such as public, private, and for-profit colleges.

**Figure 1 – Event Count per Year**



Our position in this Essay is that the enforcement of regulatory violations in the student financial aid space is perhaps less important than the hidden actions taken by educational institutions that are charged with administering the system. Regulation is a process of co-production. Traditionally, agencies would decide the “rules of the game,” but the rules are made real when regulated entities comply with them. If we account for Baron’s views on regulation as a system, regulated entities also have good reason to help shape the rules of the game.<sup>36</sup> In this view, formal enforcement is just the “tip of the iceberg”—most of the

36. See, e.g., Baron, *supra* note 15.

interesting actions occur in making the rules and then in the myriad decisions in the compliance process.

It is the compliance process that provides opportunities for regulated entities to complain about “regulatory burden.” Consider the results from the Higher Education Regulations Study, carried out by the U.S. Advisory Committee on Student Financial Assistance in 2010 and 2011.<sup>37</sup> As noted in the media, the results were headline-inducing: “[e]ighty-six percent of officials found regulations under the Higher Education Act burdensome or overly burdensome. Of the 15 regulations the panel asked about, a majority of respondents said 14 were ‘burdensome’ or ‘very burdensome,’ and cited 13 whose elimination would yield significant savings for colleges.”<sup>38</sup> As part of the 2008 HEA reauthorization, the Committee completed a review of regulations to search for rules that were “duplicative, no longer necessary, inconsistent with other federal regulations, or overly burdensome.”<sup>39</sup> Perhaps the strongest statement made about the results was that:

Respondents also criticized the “one size fits all” approach to regulation: 83 percent of executives and 73 percent of office administrators said they supported sector-specific regulations, and

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37. U.S. ADVISORY COMM. ON STUDENT FIN. ASSISTANCE, HIGHER EDUCATION REGULATIONS STUDY FINAL REPORT (2011), <http://www.chronicle.com/items/biz/pdf/HERS%20Final%20Report.pdf> [hereinafter U.S. ACSFA REPORT]. In full disclosure, one co-author served as a design consultant on the survey that formed the basis for most of the findings reported in the 2011 Higher Education Regulations Study of the U.S. Advisory Committee on Student Financial Assistance.

38. Libby A. Nelson, *Too Many Rules*, INSIDE HIGHER ED (Sept. 29, 2011), [https://www.insidehighered.com/news/2011/09/29/report\\_examines\\_regulatory\\_burden\\_on\\_colleges\\_for\\_financial\\_aid](https://www.insidehighered.com/news/2011/09/29/report_examines_regulatory_burden_on_colleges_for_financial_aid). Of course, there are situations that administrators are not likely to identify as particularly burdensome that those outside the market—or even consumers inside the market—may see as burdensome, but the overall point of such analyses is that they are almost uniformly assessed from the perspective of those responsible for compliance on the part of universities and schools. See U.S. ACSFA REPORT, *supra* note 37, at 5–6. The specific regulations for which feedback was requested included: “Conflicting Information; Entrance Counseling for Student Loan Borrowers (Entrance Counseling); FSEOG Priority Awarding Criteria (FSEOG Priority Awarding); Crediting Federal Student Aid to Non-Allowable Institutional Charges (Non-Allowable Charges); Written Authorization to Open a Bank Account on Behalf of a Student (Opening Bank Account); Prior Award Year Charges (Prior Year Charges); Proration of Annual Loan Limits (Proration of Loan Limits); Overlapping and Inconsistent Timeframes for Reporting and Consumer Disclosure Requirements (Reporting Timeframes); Volume and Scope of Reporting and Consumer Disclosure Requirements (Reporting Volume and Scope); Return of Title IV Funds; Return of Uncashed Credit Balance Checks (Return of Uncashed Checks); Self-Certification of Non-Title IV Student Loans (Self-Certification); TEACH Grant Eligibility Rules (TEACH Grant Eligibility); Overaward and Overpayment Tolerances (Tolerances); Determining Student Eligibility for Two Federal Pell Grants in One Award Year (Two Pell Grants)” *Id.* at 6. For more details, see also *id.* app. B at 55–58.

39. U.S. ACSFA REPORT, *supra* note 37, at 1.

82 percent and 69 percent, respectively, said they supported performance-based regulations. Less than 15 percent of each group favored maintaining the current approach.<sup>40</sup>

Although the nature of the media's reaction to the study is indicative of the results as represented in the report, the results were only narrowly discussed in policy debates.

Perhaps one reason was that this study followed a series of other reports that also conferred the widespread belief that the regulatory environment was broken. Since 1995, there have been three major initiatives to reduce the regulatory burden for institutions administering student financial assistance programs. The 1995 Regulatory Reinvention Initiative was meant to review "rules and procedures to reduce regulatory and paperwork burden" and to change regulations that were "outdated or otherwise in need of reform."<sup>41</sup> The 1998 HEA reauthorization required ED to again review regulations, which became the 1999–2000 Student Financial Assistance Regulatory Review.<sup>42</sup> The 2001 FED UP Initiative again sought streamlining and simplification of regulation and the paperwork required under the HEA.<sup>43</sup>

Each of these initiatives led to changes. For instance, the 1995 changes "resulted in modifications to more than 40 sections of the Title IV regulations," the 2000 changes also modified around 40 sections, and the FED UP initiative led to special rulemaking sessions and additional legislation that modified over 50 sections.<sup>44</sup> Clearly, changes in regulation occurred over time in response to such inquiries.

These three initiatives also provide a lens for observing the role of affected interests in working to change the regulatory environment. "Each of these prior reviews . . . progressively included more members of the affected community through comments and negotiations."<sup>45</sup> The 2011 report marked a change, though, in study design in that the agency wanted widespread participation of broad classes of institutions with regard to perceptions of the compliance process.

Two points bear further consideration. The first is that designing such a study requires participation when (a) entities are involved in a compliance process (and thus perhaps in adversarial positions with regard

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40. Nelson, *supra* note 38.

41. Student Assistance General Provisions, 60 Fed. Reg. 61796 (Dec. 1, 1995) (codified at 34 C.F.R. § 668).

42. See U.S. ACSFA REPORT, *supra* note 37, at 1–2.

43. See, e.g., Fed Up Higher Education Technical Amendments of 2002, H.R. 4866, 107th Cong. (2002); U.S. ACSFA REPORT, *supra* note 37, at 1–2; Memorandum from President William J. Clinton on Reg. Reform to Heads of Departments and Agencies (Mar. 4, 1995), <https://www.gpo.gov/fdsys/pkg/PPP-1995-book1/pdf/PPP-1995-book1-doc-pg304.pdf>.

44. U.S. ACSFA REPORT, *supra* note 37, at 1–2.

45. *Id.* at 2.

to the collection of accurate data), and (b) those same entities have interests that vary in terms of the net benefits they receive from compliance (*e.g.*, in terms of reducing competition for their educational products). A further point could be made that many of the benefits of regulation are only reportable by two other sets of actors whose participation was not solicited in this study—the consumers seeking financial assistance and the government as holder of the broad loan portfolio.

Even if we ignore those secondary interests, the problems of strategic response bias remain. This tendency is only enhanced by the evolution of a strong adversarial relationship between regulators and the regulated. One way in which this played out in the context of this study was that surveys of regulated entities work best when conducted in face-to-face settings where the participation of knowledgeable actors can be verified. (In this study, responses were requested from both organizational leaders and those who manage the compliance process. The first type of respondent should have been able to speak to the overall organizational cost of compliance, while the other could speak to the cost of individual compliance requirements.) Response quality depends on the respondents having direct knowledge of the compliance process.

This possibility was complicated in the case of the HERS study. In 2010, GAO responded to broad concerns about regulatory compliance among for-profit organizations by deploying “mystery shoppers” to investigate.<sup>46</sup> The use of these fictional students uncovered a number of practices that drove further concern about compliance:

At all but two of the [15] colleges visited, college employees offered deceptive or questionable information about graduation rates, exaggerated likely earnings, or guaranteed applicants jobs after graduation. An employee at a small beauty college told an applicant that barbers can earn \$150,000 to \$250,000 annually. According to Bureau of Labor Statistics data, 90 percent of barbers make under \$43,000 a year. At a college owned by a publicly-traded company, an employee told an undercover applicant that instead of pursuing an associate degree in criminal justice, she should go after a medical assisting certificate with which, after nine months of school, she would be able to earn as much as \$68,000 a year.<sup>47</sup>

The GAO findings are notable, but little recognized is how the GAO research strategy made it difficult for others to obtain access to

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46. GAO-10-948T, FOR-PROFIT COLLEGES, *supra* note 1.

47. Jennifer Epstein, *Congress's 'Secret Shopper,'* INSIDE HIGHER ED. (Aug. 3, 2010), <https://www.insidehighered.com/news/2010/08/03/gao>.

respondents working in compliance. It is easy to see how financial aid officers might confuse an on-campus inquiry with a sting operation. This issue was amplified by ED OIG's use of undercover agents in a 2007 student-aid fraud investigation, and ED's hiring in 2011 of two outside research firms to employ mystery shoppers to identify fraud.<sup>48</sup> In sum, "[m]ystery shopping represents a new form of oversight conducted by the Education Department, which had conducted program reviews and relied on tips from school employees and whistleblower lawsuits to uncover fraud."<sup>49</sup>

The study was administered via an anonymous and confidential web-based survey instrument.<sup>50</sup> Unfortunately, the goals of anonymity and confidentiality precluded the use of a known sampling frame.<sup>51</sup> One of the direct costs of the secret shopper initiatives was the loss of ability to make any statistical statements about the incidence of these views on regulatory burden within the broader community of regulated entities. This is remarkable because unlike many other social scientific enterprises, the population of affected institutions is known *ex ante*; while the responsible individuals may be unknown, their organizational location is known with certainty. However,

numerous discussions with campus officials, association representatives, consultants, and review panelists revealed significant concerns in the community over the sensitive nature of questions addressing campus-level perceptions of regulatory burden, especially regarding processes managed by the federal government. A substantial number of individuals refused to participate in a survey on such topics if they or their institutions were identifiable.<sup>52</sup>

Perhaps more troubling is the fact that, for the 2,098 respondents (425 executives and 1,673 office administrators), primary findings such as 42% of respondents perceiving the process as "overly burdensome" and 44% perceiving it as "burdensome" cannot be broken down by type of institution.<sup>53</sup> For the sample as a whole, only 8% of respondents were from private for-profit institutions, while 32% were from four-year private non-profits, 28% from four-year publics, and 28% from two-year

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48. Jim McElhatton, *Education Department Deploys 'Mystery Shoppers' to Check for Fraud*, WASH. TIMES (Feb. 15, 2012), <http://www.washingtontimes.com/news/2012/feb/15/education-department-deploys-mystery-shoppers-to-cl/>.

49. *Id.*

50. U.S. ACSFA REPORT, *supra* note 37, at iii.

51. *Id.* at 6.

52. *Id.*

53. *Id.* at 11.

public and private institutions (the remaining were from graduate/professional only institutions).<sup>54</sup> The raw incidence of few for-profits is suggestive itself. More troubling, perhaps, is that the underlying data from the survey are unavailable in any form for ex-post analysis of differential patterns across the survey responses.<sup>55</sup> Only simple tabulations remain available.

The consequence of this situation is that although 83% of executives and 73% of office managers agreed that sector-specific regulatory reforms were desirable, it is not possible to delve into the report's statement that "support for sector-specific regulations differed by institutional type and control."<sup>56</sup>

The incentives to support regulatory reform (or to report regulatory burden) depend on a firm's competitive situation in a market. Over time, two trends are evident in the regulatory space for student financial assistance. First, as federal involvement in backstopping the lending process increased, calls came to reform the regulatory compliance process for post-secondary education institutions.<sup>57</sup> Second, with each reform opportunity, the trend was towards greater involvement by those institutions in the process of identifying reform opportunities.<sup>58</sup>

However, two additional trends are also evident. Along with the calls for regulatory reform, there was also pressure to search for and prosecute fraud (often seen as located in the for-profit sector).<sup>59</sup> The second, a counter-trend, is that the search process complicated the gathering of data about the prospects and need for regulatory reform.

Where does this leave the assessment of opportunities for institutional change in the student financial assistance regulatory space? On the one hand, the most significant assessment of the regulatory compliance process indicates (a) strong dissatisfaction with the current system and (b) strong beliefs that reform should be sector-specific. On the other hand, these findings are only indicative: we have little information about the participation of different organizations in this process, we know nothing about how perceptions vary by sector, and the process was damaged by a growing distrust on the part of compliance agents about the motivations of regulators who request feedback about the process. Further, these concerns are only intensified by a long history on the part of regulated

54. *Id.* at 53.

55. Confirmed to the authors in personal communications with William J. Goggin, Executive Director, U.S. Advisory Committee on Student Financial Assistance (Jan. 16, 2015), and Anthony P. Jones, former Director of the Higher Education Regulations Study, U.S. Advisory Committee on Student Financial Assistance (Jan. 16, 2015).

56. U.S. ACSFA REPORT, *supra* note 37, at 27.

57. *Id.* at 42.

58. *Id.* at 3.

59. *See, e.g.*, GAO-10-948T, FOR-PROFIT COLLEGES, *supra* note 1, at 4.



entities to use regulation to strengthen competitive positions, damage competitors, and shape market outcomes.

#### IV. CONCLUSION

We began this Essay by reviewing the development of the concept of regulatory burden within the context of our understanding of the relationship between states and markets. Financial aid policy space is a special regulatory environment; its general structure can be understood only if we consider the special role of regulation in business-government relations. While different types of evidence exist about the financial assistance regulatory environment, given the long-term concern about regulatory burden in this arena, we argue that regulators should consider the possibility that some market segments are over-regulated, and others are under-regulated. Yet, the problem of interpreting and managing regulatory burden means we must consider whether differential regulation changes the incentives of different market actors.

The three notable GAO reports reviewed at the beginning of this paper show the attention given to the ability and willingness of post-secondary institutions to convince students to take on substantial debt.<sup>60</sup> The U.S. federal government's student-loan debt portfolio of roughly \$1.4 trillion means it cannot ignore the possibility of fraud, but the trend toward regulatory reform also introduces real dilemmas about optimization when there is a rich array of market actors.<sup>61</sup>

The fashion of pointing to "regulatory burden" makes it difficult to assess the procedures for joint implementation of this system. The 2013 call from the NASFAA for "greater transparency," "a more detailed understanding," and "constructive dialogue" makes neutral assessment problematic.<sup>62</sup> Balancing regulatory burden with protection against predatory practices is complicated by the federal government's unique role as a central purchaser of education.

Inevitably, policy improves when information is available that accurately reflects the differential incentives of market actors. It is unfortunate that a conflagration of events has concealed such information from designers tasked with improving the regulatory environment. While it is natural to hope that the next reform initiative will improve our information base for making such important policy decisions, the track record suggests differently.

Yet, the trends present in this domain show exactly why such

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60. GAO-09-600, PROPRIETARY SCHOOLS, *supra* note 1; GAO-10-948T, FOR-PROFIT COLLEGES, *supra* note 1; GAO-11-10, HIGHER EDUCATION, *supra* note 1.

61. See OFF. OF FED. STUDENT AID, *supra* note 6.

62. NASFAA, *supra* note 9, at 7.

information is hard to come by. Regulated entities have incentives, one of which is to shape the information regulators have for improving the system. In the end, a neutral third-party would be best positioned for gathering, processing, and interpreting such information. Parties like NASFAA have interests, and parties like the Advisory Commission are limited to a degree by the fraud investigations of GAO and ED. Academics are probably best positioned for such a task.

