Kicking Capitalism Out of College

By: Zachary D. Limbaugh

Introduction

The founding fathers believed that the general diffusion of knowledge to all citizens through a public nonsectarian educational system was vital to creating a unified American regime.[2] In his recent State of the Union address, President Obama stated, "Every American will need to get more than a high school diploma, and by 2020 America will once again have the highest proportion of college graduates in the world."[3] If the United States is to become the nation with the highest proportion of college graduates we must determine how that education will be provided and what role for-profit institutions will play in providing it.

This article will examine the current debate over the role of for-profit institutions in higher education. Part I will provide a brief overview of the for-profit higher education industry as compared to traditional non-profit institutions. Part II will discuss growing concerns about student loans and federal funding associated with the for-profit sector. Part III will examine possible solutions aimed at addressing concerns with the for-profit sector and goals for the future of higher education in America.

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2 MICHAEL J. KAUFMAN & SHERELYN R. KAUFMAN, EDUCATION LAW, POLICY, AND PRACTICE 22 (2d ed. 2009).

3 President Barack Obama, State of the Union Address (Jan. 27, 2010) (transcript available at http://stateoftheunionaddress.org/2010-barack-obama).

I. Overview of for-profit colleges in the United States

Currently there are nearly 3,000 for-profit career colleges in the United States.[4] Enrollment in these institutions has grown by an average of 9% per year over the past 30 years compared to a 1.5% overall growth in higher education enrollment.[5] Of the roughly 19 million students who enroll at degree-granting institutions each year, the for-profit schools educate about 2.6 million or 10% of them.[6] Harris Miller, President of the Career Colleges Association, a lobbyist for the for-profit schools, says that the industry is doing well, with nearly 2.8 million students in attendance the industry has seen approximately 25% growth per year.[7] Half of these for profit institutions now offer associate, bachelor's or professional degree programs, up from only 10% offering such programs in 1990.[8] Moreover, more than 90% of the students at for-profit colleges are now enrolled in these degree programs, and only 30% of the for-profit students are enrolled part-time.[9]

In a letter to Arne Duncan, the US Secretary of Education, 18 members of Congress outlined the make-up of for-profit industry students. The letter states that, "76% of these students live independently without parental support, 63% are 24 years old or older, 54% delayed

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4 Robin Wilson, *For-Profit Colleges Change Higher Education's Landscape,* CHRON. HIGHER EDUC. (Wash., D.C.), Feb. 7, 2004.

5 *Id.*

6 *Id.*

7 *Frontline: College Inc.* (PBS television broadcast May 4, 2010) (transcript available online at www.pbs.org).

8 WILSON, *supra* note 3.

9 *Id.*

postsecondary education after high school, 47% have dependent children, and almost one-third of the students are single parents."[10]

Of the roughly 3,000 for-profit institutions, around 40% are owned by one of 13 large publicly traded companies.[11] Jeffery M. Silber, a stock analyst and managing director of BMO Capital Markets estimates that the for-profit sector made approximately $26-billion in 2009.[12] The PBS news show Frontline reports that approximately 75% of the for-profit industries revenue comes from federal loans and grants.[13] By the 2011-12 school year the administration now estimates, students at for-profit schools should receive more than $10 billion in Pell grants, that's more than their public counterparts.[14]

The largest for-profit institution in the United States is the University of Phoenix, started by John Sperling in 1976.[15] The University of Phoenix has grown from 25,100 students in 1995 to over 455,600 students currently enrolled.[16] The Chronicle of Higher Education states it clearly, "That means that 15 years ago Phoenix was about the same size as George Washington University, now it is larger than the entire undergraduate enrollment of the Big Ten."[17] Phoenix

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10 Letter from Hon. Donald Payne, John Kline, Alcee Hastings, Carolyn McCarthy, Jason Altmire, Joe Courtney, Brett Guthrie, Howard McKeon, Baron Hill, Debbie Wasserman Schultz, Mark Souder, Corrine Brown, Judy Biggert, Ron Klein, and Suzanne Kosmas, Members of Cong., to Hon. Arne Duncan, Sec'y, U.S. Dep't of Educ. (Mar. 22, 2010 (on file with author).

11 Wilson, *supra* note 3, (quoting interview with Jeffery M. Silber, stock analyst and managing director of BMO capital Markets).

12 *Id.*

13 *Frontline: College Inc., supra* note 6

14 Peter S. Goodman, *In Hard Times, Lured into Trade School and Debt,* N.Y. TIMES, Mar. 13, 2010.

15 Daniel Golden, *Apollo Suffers New York Snub as SEC Probes Phoenix (Update3),* BLOOMBERG BUS.WK. (Jan. 19, 2010), www.bloombergtraining.com/apps/news.

16 Wilson, *supra* note 3.

17 *Id.*

has 200 campuses in 39 states, Canada, Mexico, the Netherlands, and Puerto Rico, although much of its growth has been attributed to students who work primarily online.[18]

The University of Phoenix is owned by the Apollo group which went public in 1994. For the first 15 quarters Apollo's stock broke records for profits in an otherwise flat market.[19] Mark DeFusco, a former Director at the University of Phoenix, recalls his personal earnings, "I did better than I ever imagined.[20] Jack Sperling is now a billionaire and many of the Phoenix executives have reached millionaire status.[21] Phoenix got 86% of its $3.77 billion in revenue in FY 2009 from Department of Education grants and loans that were made to students, up from 48% in 2001, according to its 2009 10-K filing with the Securities and Exchange Commission.[22]

Abandoning the traditional approaches and constraints of higher education has enabled Phoenix to remain profitable and continue its expansion. In an interview with Frontline, Mark DeFusco outlined what he perceived to be some of the reasons for the success and growth of the University of Phoenix.[23] For example, the University of Phoenix starts classes every five weeks opposed to the traditional semester approach.[24] In addition, Phoenix did away with tenure for faculty who are now retained with short term contracts.[25] DeFusco stated that the short term faculty contracts allowed him to replace faculty who did not produce the desired results.[26]

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18 *Id.*

19 *Frontline: College Inc., supra* note 6

20 *Id*.

21 *Id*.

22 Golden, *supra* note 14.

23 *Frontline: College Inc., supra* note 6, (interview with Mark DeFusco, Dir. Univ. of Phoenix, 1994-2002).

24 *Id*.

25 *Id*.

26 *Id*.

Phoenix also focuses on online courses and campuses built near major freeways approximately 20 min apart with the commuting student in mind.[27] The general mindset of the Phoenix model is to focus on training for the growth sectors and tailoring its programs to the needs of students.

II. Growing concerns over for-profit institutions

Despite the growth of for-profit institutions in the recent past, several concerns have been raised about the role they should play in higher education. Many have come to question the underlying principles of a for-profit model and the effects that it may have on those seeking a higher education. Critics point to the need for constant growth in profitability for shareholders as a catalyst for unfair and fraudulent recruitment practices. Others see the profit motivation as a contradiction to the purpose of higher education as part of the public trust. Questions over accreditation and quality standards have caught the attention of regulators seeking to protect the interests of students in the for-profit sector. Examining the record of several leading for-profit institutions provides insight into the nature and extent of these concerns. Section A will discuss the concern over student debt and loan default in the for-profit industry. Section B will highlight concerns over the recruitment practices of for-profit institutions. Section C will examine the issues surrounding the quality and accreditation of for-profit schools.

A. Student Loans

Outstanding student loans across all college sectors are roughly equal to America's total credit card debt, about $750 billion.[28] With the amount of student debt growing increasingly larger, many have grown concerned about the ability of students to repay their loans.

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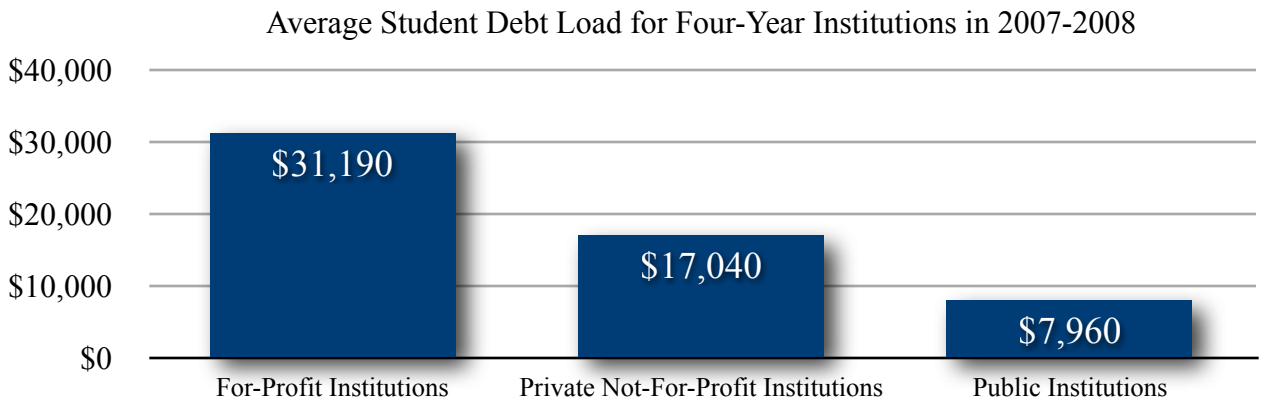
27 *Id.*

28 *Frontline: College Inc., supra* note 6

Representative George Miller the Chairman of the House Committee on Education and Labor stated, "It sort of reminds me of where we were two years ago, with liar loans and no-doc loans in the housing market, where people started accepting people who couldn't prove their income, couldn't prove employment, but we sold them a $450,000 house."[29] According to the 2007-2008 National Postsecondary Student Aid Study the average debt load in 2007-2008 for students enrolled in four year institutions was as follows:



For-profit institutions have become the target of much of the concern over student loan defaults. Harris Miller, the chief lobbyist for the for-profit colleges insists that the default rate of for-profit students is around ten or eleven percent, a relatively low figure.[30] However, Barmak Nassirian a lobbyist for traditional universities argues that the actual default rate of students at for-profit institutions is closer to 50%.[31] Frontline reports that according to recent government figures for-profit institutions represent about 10% of the students and about 44% of all student

29 *Id.* (interview with Rep. George Miller, Chairman, H. Comm. on Educ. and Labor).

30 *Frontline: College Inc., supra* note 6, (interview with Harris Miller, Pres., Career Coll. Ass'n).

31 *Frontline: College Inc., supra* note 6, (interview with Barmak Nassirian, Ass'n of Admissions Officers).

loan defaults.[32] One reason that for-profit institutions are able to claim low default percentages is because of the narrow definition of "default". Default as referred to by the for-profit sector are those loans where the student has failed to make payments within the first two years of repayment.

In the 1990's Congress sought to crack down on for-profit institutions with high student default rates. In response they passed legislation that would bar schools from the federal financial aid programs if more than a quarter of their students consistently defaulted on their loans within two years of graduating or dropping out.[33] According to Stephen Burd a senior staff member in the New America Foundation's Education Policy program and editor of Higher Ed Watch, the for-profit institutions have found ways to get around these caps.[34] Burd says that many of the for-profit institutions, "began hiring agencies to help former students get forbearances or offering lines of credit so alums could make their student loan payments-but only during the initial two-year window, when defaults were counted against the school by the Department of Education."[35] This may explain the discrepancies in the industries default figures.

Federal student loans are among the most collectible types of debt. Federal loans are not dischargeable in bankruptcy.[36] Those who default are subject to wage garnishment, law suits, and property liens, as well as having their tax refunds intercepted, becoming ineligible for federal employment, and becoming ineligible for any other kind of federal benefits.[37]

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32 *Id.*

33 Steven Burd, *The Subprime Student Loan Racket,* WASH. MONTHLY, Dec. 2010.

34 *Id*.

35 *Id*.

36 *Frontline: College Inc., supra* note 30, (interview with Barmak Nassirian).

37 *Id*.

Besides federal loans many institutions have begun assisting students in securing private loans as well.[38] Private loans became necessary after Congress passed legislation requiring students to get at least 15% of their funding from non-federal sources.[39] The percentage of for-profit students taking out private loans has increased from 16 to 43 percent between 2004 to 2008.[40] In 2008 Sallie Mae quit offering subprime private loans to students at for-profit colleges because of the astronomical default rates.[41] However, now that private lenders have been forced out of federal student loan programs there is concern that they will become increasingly involved in private lending. Opposed to the federal student loans which have a relatively low fixed interest rate, the private loans often have a flexible rate that can reach as high as 20%.[42]

The price of attending a for-profit institution is five to six times higher than the tuition of a typical community college and usually twice the tuition of a traditional four-year public institution.[43] Nevertheless, the tuition continues to increase at approximately 6-7 percent per year. While students continue to default on their loans the for-profit sector continues to post profits.[44]

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38 Burd, *Supra* note 32.

39 *Id*.

40 *Id*.

41 *Id*.

42*Id*.

43 *Frontline: College Inc., supra* note 6

44 *Id*.

B. Recruitment Practices

Critics of the for-profit sector have become increasingly concerned over the recruitment practices of these institutions. The profit model requires a consistent growth of students which has led many to question whether those recruited are really qualified or likely to succeed in the programs. As Jeffrey Silber put it, in order for the University of Phoenix to remain profitable and grow, with all the students that leave each year "it would need to add the equivalent of one and a half Ohio State's each year."[45] Maintaining that kind of growth has required substantial advertising as well. Last year the University of Phoenix reportedly spent $135 million in advertising, more than major companies like FedEx, Tide, and Revlon.[46] Former Director of Phoenix Mark DeFusco told Frontline that the industry typically spends around twenty to twenty-five percent of its revenue on advertising, while spending only ten to twenty percent on faculty.[47]

Several lawsuits have been filed by former students of for-profit schools alleging aggressive recruitment tactics and fraudulent statements made during recruitment. In 2008 the Department of Education took suit against the University of Phoenix for allegedly violating a rule that prohibits paying recruitment advisors solely on the number of students they bring in.[48] While Phoenix admitted no guilt and maintained its innocence, the school settled out of court with the Department and two whistle blower former employees for $67 million.[49]

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45 *Frontline: College Inc., supra* note 6, (interview with Jeffery Silber, analyst BMO Capital Markets).

46 *Frontline: College Inc., supra* note 6

47 *Id*. (Interview with Mark DeFusco).

48 *See* Second Amen'd Complaint, *United States ex rel. Mary Hendow and Julie Albertson v. Univ. of Phoenix*, (E.D.C.A. 2004)(No. CIV .S-03-0457 GEB DAD).

49 *Frontline: College Inc., supra* note 6

Allegations of aggressive and fraudulent recruitment tactics have been made against several for-profit institutions. Drake University has been the target of some of these allegations. Almost five percent of the student body at Drake's Newark, New Jersey, branch were homeless individuals according to their director of admissions and student services.[50] In late 2008, Drake began offering a $350 biweekly stipend to students who showed up to 80% of classes and maintained a "C" average.[51] A case manager at the local shelter said that it was basically known in the community that, "If you're homeless, and you need some money, go to Drake."[52] Chancellor University in Cleveland began explicitly focusing its recruitment efforts on local shelters after it realized that the University of Phoenix was also doing so.[53] However, both Chancellor and Phoenix have discontinued the practice and Phoenix now says that its business code prohibits recruiting at shelters.[54]

These types of recruitment tactics show that the for-profit institutions pursuit of high enrollment numbers needed to sustain profitability may be in conflict with its duty to ensure that it recruits students capable of success.

C. Quality and Accreditation

Many are concerned with the quality of the education being provided by the for-profit institutions. The U.S. Department of Education website warns against what it calls, "diploma mills" or institutions that offer little actual training or education.[55] The Department offers an

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50 Daniel Golden, *Homeless High School Dropouts Lured by For-Profit Colleges,* BLOOMBERG BUS.WK. (Apr. 30, 2010), www.bloombergtraining.com/apps/news.

51 *Id*.

52 *Id*.

53 *Id*.

54 *Id*.

55 http://www2.ed.gov/students/prep/college/diplomamills/index.html

online list of schools that have been accredited by some authority but warns that students should investigate an institution before enrolling.[56]

Frontline recently interviewed several nursing students who graduated from Everest College in 2008.[57] Each of the students were told that they would be making $25 an hour after graduation as nurses, and paid almost $30,000 in tuition for the 12 month program.[58] Even though all three students graduated and obtained their licenses, they have all struggled to find jobs.[59] The students claim that their training was inadequate.[60] According to Frontline, "they were given no practical experience in hospitals, as they say they were promised, only in nursing homes and health clinics."[61] The students claimed that they never set foot in a hospital, that for their psychiatric rotation they were taken to a museum of Scientology, and for their pediatric rotation they were taken to a day care.[62] Corinthian Colleges, the owner of Everest responded to Frontline by saying. "the nurses' course provided thorough and appropriate training and that students were fully informed that sites were subject to change at any time."[63] Unfortunately, these students are not alone in their claims that the education they received from a for-profit institution was inadequate. While there are undoubtedly countless stories of students satisfied

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56 *Id*.

57 *Frontline: College Inc., supra* note 6

58 *Id*.

59 *Id*.

60 *Id*.

61 *Id*.

62 *Id*.

63 Letter from Stan A. Mortensen, Exec. Vice Pres. and Gen. Counsel, Corinthian Coll. Inc., to Martin Smith, Producer/Corespondent, Frontline (Apr. 27, 2010) (on file with author) (also available at http://www.pbs.org/wgbh/pages/frontline/collegeinc/responses/corinthians.pdf.).

with their for-profit education. However there remains a risk that dedication to shareholders may conflict with the dedication to providing quality education.

Further concern has grown over the purchase of non-profit institutions by investors who convert them to for-profit with the hopes of using their accreditation. Many times the investors will make significant changes to the institution, by taking it online or completely altering its curriculum. Michael Clifford, an investor in for-profit institutions, stated that a regional accreditation from investment standpoints is currently valued at $10 million.[64] Smaller non-profit schools facing pressure from the loss of donations due to the current economy are finding the unlimited capital of for-profit investors an enticing solution for keeping their schools open.[65]

Many of these colleges are acquired solely for their accreditation, like Daniel Webster College which was purchased by ITT Educational Services Inc.[66] Webster was purchased for $20.8 million, yet Bloomberg Businessweek reports that the schools regional accreditation may generate up to $1 billion in federal funding for ITT.[67] The regional accreditation ITT acquired by purchasing Webster is the same accreditation afforded to Harvard University. ITT's attorneys admitted that the accreditation was the "most attractive" feature of Webster.[68] The accreditation provides access to federal financial aid funding, but also enables students to transfer credits to other institutions.[69] By purchasing schools with accreditation investors sidestep the lengthy process of review that traditional institutions have to undergo. Kevin Kisner is an associate

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64 *Frontline: College Inc., supra* note 6

65 *Id*.

66 Daniel Golden, *Your Taxes Support For-Profits as They Buy Colleges,* BLOOMBERG BUS.WK. (May 15, 2010), www.bloombergtraining.com/apps/news.

67 *Id*.

68 *Id*.

69 *Id*.

professor at the State University of New York at Albany who studies for-profit higher education.[70] Kisner says that, "You can get accreditation a lot of ways, but all of the others take time. They don't have time. They want to boost enrollment 100 percent in two years. Companies are buying accreditation."[71]

With the accuracy of regional accreditation standards being undermined by the ability to bypass review and purchase accreditation there is growing concern over the true quality of for-profit education. Coupled with the aggressive recruitment tactics the overall value of for-profit education is brought into question. Of the greatest concern is that students are the ones deprived of a quality education and then made to pay for it, and when they can't federal taxpayers must take the loss. Harris Miller told Frontline that the U.S. Department of Education has the ability to cancel student debt where fraud by the institution is shown.[72] In response the Secretary of Education, Arne Duncan stated that this was not only inaccurate but asking the wrong question.[73] Duncan stated that the real question should be how to avoid the fraud in the first instance.[74] Regulation of for-profit education must be aimed at eliminating fraud before it occurs, not mitigating the damage.

III. Proposed Solutions

The Obama administration has indicated its desire to increase the number of college graduates in the United States. In an effort to realize that goal the administration proposed a $12

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70 *Id*.

71 *Id*.

72 *Frontline: College Inc., supra* note 6.

73 *Id*.

74 *Id*.

billion dollar plan to expand community colleges.[75] However, Congress reduced that plan to $2 billion dollars after lengthy debate.[76] By reducing the proposed expansion of community colleges it is likely that the for-profit sector will be the only option for meeting the increased demand for higher education. With an increase in the demand for education it is important that steps be taken to address growing concerns with the for-profit industry. Part A will discuss the proposed "gainful employment" requirement put forth by the Obama administration. Part B will discuss a National Accreditation authority as an alternative to the gainful employment requirement. Lastly, part C will discuss the need to ultimately remove federal funding from for-profit institutions and expand community college education.

A. The Gainful Employment Standard.

The gainful employment standard proposed by the current Secretary of Education, Arne Duncan seeks to eliminate concerns over the cost, value, and recruitment of for profit institutions.[77] The gainful employment standard would apply only to for-profit institutions. Gainful employment requires that upon graduation students should be able to find employment sufficient to pay back their student loans.[78] Institutions where the graduates would not be able to find employment that would enable them to repay their loans would not be eligible to receive federal financial aid funding. While the for-profit industry has fought hard against these type of regulations the Obama administration has shown no signs that it will back down. As Arne

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75 *Id*.

76 *Id*.

77 Jennifer Epstein, *Going Ahead With Gainful Employment,* INSIDE HIGHER ED (Apr. 21, 2010), http://www.insidehighered.com/news/2010/04/21/gainful.

78 *Id*.

Duncan told Frontline, "where there is high-pressure tactics, where there are deceptive tactics, where there is dishonesty, we have to challenge that in a very serious way."[79]

B. National Accreditation as an Alternative to Gainful Employment

One important element that seems to be missing from Higher Education in the United States is a National Accreditation Standard. There is no point in seeing that America has the highest proportion of college graduates by 2020, unless we can ensure that the degrees those graduates have obtained are representative of a meaningful education. In order to ensure that quality is maintained I would propose the formation of a National Accreditation Board to be overseen by the U.S. Department of Education. This board would work with state and regional accreditation authorities to develop minimum standards for institutions seeking eligibility for federal financial aid funding. The National Accreditation board could develop minimum levels of performance for graduates of each institution relative to the performance of graduates from all other institutions. This system would not only protect students from the "diploma mills" warned of by the Department of Education, but would also ensure taxpayers that student loan money is being used for meaningful degree programs and not diverted to the pockets of investors.

I believe that this standard is superior to the proposed gainful employment standard. The gainful employment standard relies on the ability of graduates to find employment in the desired field. As the economy is constantly changing ability to find a job in a particular field will change dramatically in short periods of time. A student who desires to enter law school today may not be eligible for federal funding under the gainful employment standard because legal jobs are currently very scarce. However, many anticipate that the legal market will rebound, and by the

79 *Frontline: College Inc., supra* note 6, (interview with Arne Duncan).

time that student would graduate law school in three years there may be an abundance of legal jobs.

Foreclosing the opportunity for higher education based simply on the static nature of the the job market will discourage the dissemination of knowledge that our founders thought was so essential to maintaining a democratic regime. Similarly, requiring institutions to meet the minimum job requirements for those in the field is not an appropriate standard. Like the static nature of the job market, the minimum requirements for any specific job will change relative to the availability of jobs in that sector. Where there is a shortage of workers the requirements are likely to fall and where there is an abundance of workers the requirements to enter the field will likely rise as employers have the luxury of being more selective. Therefore, I believe the most appropriate standard to determine the eligibility of an institution to receive federal financial aid should be based on its ability to maintain National Accreditation by providing an education consistent with those provided by other institutions.

C. Expanding Community Colleges and Kicking Out Capitalism

The best way for America to reach our goal of having the highest proportion of college graduates in the world and maintain the quality of education is to rely on those institutions who remain in the public trust. While for-profit schools may be necessary to meet education demand in the near future, our goal should be to ultimately replace them with non-profit community colleges.

A community college can provide the necessary training for jobs that actually exist within the community, eliminating concern over job placement. Moreover, there is no reason that community colleges cannot implement some of the same techniques that have made the for-

profits successful. This includes the implementation of online curriculum and resources. Community colleges should form state or nation wide networks to share digital resources and conduct distance learning classes. In addition, community colleges should be more responsive to the needs of their students and perhaps move away from the semester approach. Because community colleges do not have to concern themselves with profits, they should be able to provide the same level of education as the for-profit schools with lower costs.

Michael Clifford, an investor who has turned around several failing colleges by taking them for-profit says that the key to turning around an institution is bringing the "three M's", money, management, and marketing.[80] Ultimately I believe that it will take all three of these elements to turn around our community school system. While the current economic climate has seen Congress unwilling to allow the $12 billion expansion of community colleges, the $2 billion may be a hint of a step in the right direction. Community colleges need to devote some of the resources they will receive from the $2 billion package to management and marketing. While tuition rates may need to increase at some of these institutions, that may be a reflection of the rising quality and cost of higher education.

It is not to say that removing federal funding from the for-profit institutions will call for their elimination. Removing eligibility for federal financial aid from for-profit colleges will prevent individuals from profiting exclusively from funds that are meant to benefit all of society. These for-profit institutions could remain open, and show their commitment to the quality of their programs by providing their own loans to their students. They would simply have to operate on the revenue generated by their alumni who are repaying the loans made by the

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80 *Frontline: College Inc., supra* note 6, (interview with Michael Clifford).

institution. Any objection to providing their own loans should be seen as an admission that an institution does not expect its student to be able to repay the loans. This would indicate that critics of the for-profit schools are correct in their allegation that the for-profit model is simply a vehicle to exploit the federal taxpayers and stick vulnerable students with a high amount of federal debt they have little chance of repaying.

Conclusion

As Plato said, education is a public, political matter that plays a critical role in shaping the character of citizens and the nature of a regime.[81] The critical role that education plays must not be left to the will of a few investors seeking to maximize profits. Institutions of higher education belong in the public trust, with the focus on the dissemination of knowledge which our founders thought essential to maintaining our democracy. While for-profit colleges may be necessary for the short term we should move forward with an eye towards kicking capitalism out of college.

81 MICHAEL J. KAUFMAN & SHERELYN R. KAUFMAN, EDUCATION LAW, POLICY, AND PRACTICE 22 (2d ed. 2009).