Fiscal Impact of School Vouchers and Scholarship Tax Credits

One argument made by policymakers who advocate for private school choice is that policies such as school vouchers and scholarship tax credits can save taxpayers money. School vouchers and scholarship tax credit programs provide tuition support for certain students who wish to transfer from the public school system into private schools. These programs frequently are designed so the amount of tuition support provided is less than the amount the state otherwise would pay for a student to attend public school; the state then recoups the difference. Policymakers can choose to reinvest the funds in state education funding, spend them on something else, or count them as budget savings.

Although this approach seems straightforward, the challenge analysts face in estimating the fiscal impact of these programs lies in determining not only the amount the state otherwise would pay for a student to attend public school, but also the cost to the state of the program as a whole. This brief discusses the factors fiscal analysts and legislators will want to consider when estimating the fiscal impact of private school choice policies, including the fiscal impact of existing programs.

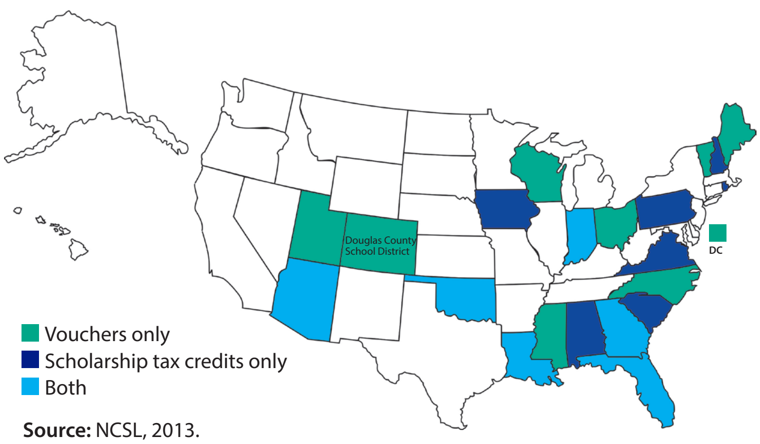
Overview of Private School Choice Policies

The two private school choice policy options focused on in this brief are the most common currently found in states. School vouchers, also referred to as opportunity scholarships, are state-funded scholarships that pay for students to attend private school rather than public school. Private schools must meet minimum standards established by legislatures in order to accept voucher recipients. Legislatures also set parameters for student eligibility that typically target subgroups of students. These can be low-income students who meet a specified income threshold, students who are attending chronically low-performing schools, students with disabilities, or students in military families or foster care.

Scholarship tax credit programs, sometimes referred to as tuition tax credits, allow individuals, corporations or both to allocate a portion of their owed state taxes to private nonprofit organizations that issue private school scholarships to K-12 students. The scholarship allows a student to choose among a list of private schools approved by the scholarship organization. The scholarship is used to pay tuition, fees and other related expenses. As a result, the state does not have to appropriate per-pupil education funding for students that receive scholarships.

The biggest difference between school vouchers and scholarship tax credits from a fiscal perspective is that vouchers create a direct expense to the state in the form of funding the scholarship, while the only cost to the state under a scholarship tax credit program is a loss in potential revenue from awarding tax credits. In a 2011 decision, the U.S. Supreme Court ruled that simply being a taxpayer does not create legal standing to claim financial harm from a tax credit, since the state did not possess the revenue in the first place (*Arizona Christian School Tuition Organization vs. Winn*).

States with Either Scholarship Tax Credits or School Vouchers



Source: NCSL, 2013.

Measuring the Fiscal Impact on States

School Vouchers

Measuring the impact of school vouchers is straightforward in that the state offers students a scholarship in exchange for transferring from a public school to a private school. If the scholarship is less than the amount the state otherwise would pay for a student to attend a public school, then the state recoups the difference. Policymakers then can choose to reinvest the spare funds into state education funding, spend them on something else, or count it as budget savings. Indiana reinvests the savings from its voucher program into its public school funds.

Scholarships offered in school voucher programs tend to be at or near the state per pupil allocation, while those offered in scholarship tax credit programs often are worth much less. Seven states with existing school voucher programs offer students scholarships equal to the amount the state would otherwise pay per student to attend public school.[1] Four states offer scholarships worth less than the state per-pupil allocation, and Utah offers students with disabilities scholarships that, given the right circumstances, can be worth more than the amount the state spends on a public school student.[2] This is, however, contingent upon the tuition a voucher student's selected private school charges, since no state allows the scholarship to exceed the tuition.

Analysts must make three major assumptions when measuring the fiscal impact of a school voucher program. Each can significantly affect the realized impact of the program:

1. Estimating how many voucher students would have attended private school without receiving the voucher,
2. Estimating how many students will apply for and receive scholarships in future years, and
3. Predicting the average scholarship award in future years.

Estimating the Number of Students Planning to Attend Private School With or Without the Voucher

Some students who receive vouchers were planning to switch from public to private school, regardless of their voucher status. It is important for analysts to know how many students choose to do this, since they do not create savings. In fact, they add to the cost of the program. Without the voucher, the state no longer would have to provide funding for them, since they are leaving the public school system. No resources are available that measure this occurrence, so fiscal analysts are left to estimate the effect on the overall fiscal impact of the voucher program. Since most voucher recipients come from low-income households, it is expected that the percentage of voucher students who fit this description is relatively small, but still significant to the fiscal impact of vouchers.

Some research attempts to measure the number of these students. A 2010 evaluation of the D.C. Opportunity Scholarship Program revealed that nearly 12 percent of students who applied for a voucher but did not receive it had enrolled in private school without the voucher within four years.[3] Due to the comparable student samples, it can be assumed within a margin of error that a similar percentage can be applied to those students who did receive the voucher. Other research on school voucher programs has estimated that 10 percent to 15 percent of students who received vouchers would have enrolled in private school without the voucher. This same research, however, has found that, without the voucher, up to half of these students return to public school within three years of attending private school.[4] The studies were performed in various regions. The accessibility and affordability of private schools in the area covered by a voucher program will likely affect the number of qualifying students who can enroll in private school without receiving a voucher.

Robert M. Costrell of the School Choice Demonstration Project—a group that conducted the federally mandated evaluation of the D.C. Opportunity Scholarship Program—suggests fiscal analysts should assume that 10 percent of voucher recipients would have attended private school without the voucher.[5] He bases this rate on research literature and private school enrollment trends, but notes that it is an estimate and likely differs among regions.

Estimating How Many Students Will Apply for and Receive Scholarships in Future Years

Analysts must estimate how many students will apply for and receive scholarships in future years. This is difficult due to the many unknown factors that can affect student participation. For example, analysts do not know how many students will meet private school admission requirements, the capacity of participating schools to meet the demand of voucher recipients, the extent to which additional capacity will be created as a result of the program, the number of voucher recipients who decide to remain in public school, the rate at which participating students return to public school before graduating high school, or the extent to which the voucher will motivate parents to seek the private school alternative. Three states have imposed a cap on the number of vouchers that can be awarded in a single year. Caps relieve some cost uncertainty because they create a maximum possible cost of the program. On the other hand, if the cap is reached, some students may be denied access to the program.

Predicting the Average Scholarship Award in Future Years

Finally, analysts must predict the average scholarship award in future years. Students are awarded scholarships equal only to the cost of tuition up to the defined maximum. Since private school tuition sometimes may be less than the maximum scholarship, the average scholarship usually is less than the maximum. This is likely to change over time, however, since some low-tuition private schools that receive a large volume of voucher students may increase their tuition in order to maximize the amount they receive from the state. There is evidence of this in Milwaukee, which has the oldest and largest modern voucher program. In a majority of participating Milwaukee private schools, voucher students make up more than 80 percent of total enrollment, and most schools report their per-pupil operating costs to be at or very close to the maximum voucher amount.[6]

Scholarship Tax Credits

Measuring the fiscal impact of scholarship tax credits is more complicated, since the state does not directly fund any part of the program. The program, however, still can significantly affect the state budget. By issuing a new tax credit, the state is forgoing tax revenue it otherwise would have collected. That lost revenue is countered by the savings realized from transferring students from publicly funded schools to private ones. The challenge for legislators and fiscal analysts is to determine not only how much revenue will be lost, but also the number of students who actually will transfer. The ability to strike the right balance between these two key factors will determine whether the program saves the state money or increases the budget. The three assumptions fiscal analysts must make to measure the fiscal impact of traditional vouchers also apply to measuring the impact of scholarship tax credits.

Statewide Tax Credit Caps

One way to control costs of a scholarship tax credit program is to impose a statewide cap on the total amount of tax credits awarded. With a cap, policymakers know the maximum amount of revenue that will be forgone. Taxpayers who wish to claim the credit must first apply to the state to verify that the cap has not been reached. Typically, credits are awarded on a first-come, first-served basis until the statewide cap is reached.

States will want to strategically set their statewide cap on credits. It must be set in balance with the number of students expected to participate in the program and transfer out of the public school system. If the cap is set too high, or if there is no cap, then a state runs the risk of not having enough student participation to balance the revenue forgone from the tax credit. Insufficient student participation means the program may cost the state rather than produce savings. An excess of scholarship donations potentially could conflict with a provision most states include in their statutes requiring scholarship organizations to spend a certain percentage (usually between 90 percent and 97 percent) of their revenue on scholarships. It should be noted that existing programs generally have not had an issue with excess donations or insufficient student participation.

In contrast, if the cap is set too low, donations to scholarship organizations may not meet the student demand for scholarships. In this event, the state would be forgoing potential budget savings because it not only would pay for students to attend public school who otherwise would transfer to a private school, but also might deny qualifying students access to the program.

Impact on Revenues

Determining the effects this new tax credit will have on state revenues depends largely upon whether the tax credit is refundable and if it can be carried forward to future years. Some states have elected to make the tax credit refundable, meaning taxpayers can claim the entire credit even if their tax liability is less than the value of the credit. In these cases, taxpayers are refunded the difference between the credit and the amount they owe in taxes.

Rather than make the credit refundable, some states allow taxpayers to carry forward unused credits to future years. If the credit is more than a taxpayer owes in taxes, the unclaimed amount can be applied to future tax returns with no additional donations needed. Some states choose neither option, instead allowing a nonrefundable tax credit that cannot be carried forward.

Some states limit the tax credit to a percentage of the total donation to a scholarship organization. This can reduce the impact the credit has on state revenues, but it also may make the credit less attractive to donors and could lead to fewer funds available for scholarships.

Existing Program Impacts on State Budgets

Florida

In 2008, Florida's Office of Program Policy Analysis and Government Accountability (OPPAGA) performed an evaluation of the Florida Corporate Income Tax Credit Scholarship Program's effect on the state budget. The evaluation found significant budget savings each year as a result of the program. OPPAGA estimated that, in fiscal year 2007-08, Florida saved $1.49 for every $1 it issued in tax credits, totaling $38.9 million in savings from the scholarship tax credit program. For FY 2008-09, OPPAGA updated its evaluation and found the state was saving $1.44 for every $1 in tax credits issued, resulting in total net budget savings of $36.2 million. The reduced savings from the original analysis largely results from a greater increase in tax credits issued than the increase in savings from students transferring to private schools.

Comparison between the two analyses is difficult because they use different estimates for the number of participating students who would have attended private school without the scholarship. The 2008 report assumed these students would account for 10 percent of program participants, while the 2010 update uses 2000 U.S. Census Data showing that 5 percent of private school students nationwide qualify for free and reduced price lunch. While the 5 percent figure is based on real data, it fails to account for variances among states and regions.

Milwaukee

The University of Arkansas's School Choice Demonstration Project performed comprehensive analyses of the Milwaukee Parental Choice Program's fiscal impact on both state and local budgets over the course of three fiscal years. It found that the program saved the state $37.2 million in FY 2009, $46.7 million in FY 2010 and $51.9 million in FY 2011. The rapid increase in savings can be attributed to the rising per-pupil allocation for public school students, combined with a decrease in the maximum voucher awarded. The greater the difference between these two figures results in greater savings.[7]

Researchers explain the importance of the ratio between the per-pupil funding for public school students and the maximum scholarship award in determining the savings. If the private school scholarship is 80 percent of the per-pupil funding for public schools, then at least 80 percent of the voucher participants must be students who would attend public school without the voucher. In this scenario, if more than 20 percent of participants would have attended private school without the voucher, then the state will experience a net cost rather than savings from the voucher program.[8]

The Charter School Effect

Some private school choice advocates have cited data showing that many private school students transfer into charter schools, which many likely see as a free alternative to private schools. A report from the CATO Institute's Center for Educational Freedom discusses how this trend can significantly affect state budgets, since these students represent additional school funding expenditures. Private school choice policies may encourage such students to remain in private school, however.[9] The data in the report simply shows changes in enrollment. It does not measure the motivation behind student transfers from private schools to charters. Insufficient data exists to make any researched-based inferences about how a private school choice program will affect this enrollment trend.

Fiscal Impact on Public Schools

Some have raised concerns about the effects of private school choice policies on school budgets.[10] Public school districts usually receive state funding based on the number of students enrolled in district schools. When a student transfers from a public school to a private school, the school district no longer receives state funding for that student. The loss of that student, however, may not proportionally reduce district operating costs because some fixed school expenses are not necessarily tied to the number of students. Expenses such as curriculum, technology and administration will not change when a handful of students accept private school scholarships. Similarly, unless a substantial number of students were to leave a single school, there would be no change in the number of teachers needed. When a handful of students leave, however, the district must cover those expenses with fewer funds.

Some evidence suggests this may not be a serious concern. In Florida, which has the highest participation in private school choice programs in the country, scholarship recipients represent just 2.7 percent of public school students statewide; thus, the loss in revenue will represent only a fraction of a school's overall revenues.[11] In addition, one analysis by the Friedman Foundation for Educational

Choice, an organization that advocates for private school choice, makes the argument that a school's fixed expenses will be affected only for the first few years of a school choice program and that, as enrollment in a school choice program stabilizes, public schools can adjust fixed expenses accordingly.[12]

While public schools will be forced to make do with less state revenue, funds they receive from local sources such as property taxes and local bond initiatives will remain the same, despite the fact that they have fewer students. Again, however, if most operating costs do not change, local revenues likely would cover the same expenses encountered with higher enrollment.

While private school choice policies are likely to negatively affect some public schools' finances, the extent of that impact will vary from school to school and is difficult to measure. Many factors—including a school's current financial situation, its current class sizes, the number of students who accept private school scholarships and the grade level of those students—will determine how a private school choice program will affect a particular school.

Questions for Legislators to Ask

- How many students will meet the eligibility requirements of a proposed voucher or scholarship tax credit program?
- What is the capacity of existing private schools to enroll participating students?
- What is the average private school tuition at both primary and secondary grade levels?
- How much does the state allocate in education funding per-pupil? How does this compare to the maximum voucher award per student?

Notes

1. Florida, Georgia, Louisiana, Maine, Mississippi, Oklahoma and Vermont offer scholarships equal to the amount the state would otherwise pay per student to attend public schools.

2. Arizona, Indiana, Ohio and Wisconsin offer scholarships worth less than the state per-pupil allocation.

3. Patrick Wolf et al., *Evaluation of the DC Opportunity Scholarship Program: Final Report* (Washington, D.C.: U.S. Department of Education, June 2010), http://ies.ed.gov/ncee/pubs/20104018/pdf/20104018.pdf.

4. Robert M. Costrell, *The Fiscal Impact of the Milwaukee Parental Choice Program in Milwaukee and Wisconsin, 1993-2008* (Fayetteville, Ark.: School Choice Demonstration Project, February 2008), www.uark.edu/ua/der/SCDP/Milwaukee_Eval/Report_02.pdf.

5. Robert M. Costrell, "Who Gains, Who Loses?: The fiscal impact of the Milwaukee Parental Choice Program," *Education Next* 9, no. 1 (2009), http://educationnext.org/who-gains-who-loses.

6. Patrick J. Wolf et al., *Milwaukee Parental Choice Program: Descriptive Report on Participating Schools* (Fayetteville, Ark.: School Choice Demonstration Project, February 2012), www.uark.edu/ua/der/SCDP/Milwaukee_Eval/Report_33.pdf.

7. Robert M. Costrell, *The Fiscal Impact of the Milwaukee Parental Choice Program: 2010 – 2011 Update and Policy Options* (Fayetteville, Ark.: School Choice Demonstration Project, December 2010), www.uark.edu/ua/der/SCDP/Milwaukee_Eval/Report_22.pdf.

8. Costrell, *The Fiscal Impact of the Milwaukee Parental Choice Program*.

9. Adam B. Schaeffer, *The Charter School Paradox* (Washington, D.C.: Cato Institute, August 2012), www.cato.org/sites/cato.org/files/pubs/pdf/charter-school-paradox.pdf.

10. "10 Reasons Why Private School Vouchers Should Be Rejected," *Church & State* (February 2011), www.au.org/church-state/february-2011-church-state/featured/10-reasons-why-private-school-vouchers-should-be.

11. Friedman Foundation for Educational Choice, *The ABCs of School Choice* (Indianapolis, Ind.: Friedman Foundation for Educational Choice, 2013), www.edchoice.org/CMSModules/EdChoice/FileLibrary/965/The-ABCs-of-School-Choice---2013-edition.pdf; Office of Funding and Financial Reporting, *Florida Education Finance Program 2012-13: Fourth Calculation* (Tallahassee, Fla.: Florida Department of Education, April 19, 2013, www.fldoe.org/fefp/pdf/12-13-fourth.pdf.

12. Benjamin Scafidi, *The Fiscal Effects of School Choice Programs on Public School Districts* (Indianapolis, Ind.: Friedman Foundation for Educational Choice, March 2012), www.edchoice.org/CMSModules/EdChoice/FileLibrary/796/The-Fiscal-Effects-of-School-Choice-Programs.pdf.

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