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NEPC POLICY MEMO

HOW TO CALCULATE THE COSTS OR SAVINGS OF TAX CREDIT VOUCHER POLICIES

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In this NEPC Policy Memo, Professor Welner explains that the most honest and conscientious approach to reporting the fiscal impact of tax credit vouchers is to provide a range of outcomes and let the readers—not the legislative analysts themselves—speculate on which is most likely. If a bottom line is demanded, it should be couched in as many cautions and limitations as can be fit on the page.

Introduction

The nation has seen a recent growth in policies that generate private school vouchers through a tax credit mechanism. Those policies exist in seven states: Arizona, Florida, Georgia, Indiana, Iowa, Pennsylvania, and Rhode Island. An additional five or so states are giving serious consideration to similar legislation. In connection with such bills, legislative analysts are being called upon to generate fiscal notes—estimates of the likely fiscal effects of the legislation on state budgets. As described below, the problem faced by these analysts is that the fiscal effects depend on little more than conjecture. This guesswork, or "educated guessing" at best, is nonetheless grounded in fairly straightforward dynamics. This *NEPC Policy Memo* explains those dynamics and suggests how the cost effects of these voucher-like policies should be calculated and understood.

The Fundamental Issue of Switchers: Introducing Mary and John

The basic idea behind these policies is that amounts owed to a state in corporate or individual income taxes can be diverted into charitable donations to non-profit corporations which then bundle the money and hand it out as private-school vouchers. As a tax *credit*, the policy gives the donor a tax benefit beyond what would be available for other charitable donations. In some states, that benefit is dollar-for-dollar, reducing the donor's state tax obligation by the full amount of the donation.

I use the term "neovouchers" to describe this process, to distinguish the resulting vouchers from the conventional type funded directly by the state.[1] Neovouchers can save the state money when families are prompted by the voucher availability to switch from public to private school. If, for instance, John enrolls in first grade in his local public school, the public funding might be about $8,000 per school year. But if John uses a $4,500 neovoucher to switch from public to private school, the state can be considered to have saved the $3,500 difference.

But consider John's classmate, Mary. She also received a $4,500 neovoucher, but her parents had always intended to enroll her in private school, which they would otherwise have paid for all by themselves. While the state saved $3,500 on John, it lost $4,500 on Mary.

The neovoucher recipients in a given state will be made up of mix of Johns and Marys. But to calculate the budgetary impact of the program, we would have to know the exact nature of that mix. The state cost or savings would also depend on the specific number of switchers and non-switchers.

While other factors should also be considered (some are set forth later in this *Policy Memo*), it is this switcher issue that sits in the middle of the room as the three-ton elephant giggling at legislative analysts: *How many families are being enticed by the neovoucher to switch, relative to the number of families who already plan on private schooling and are simply grateful for the new state subsidy?*

Truth is, no one knows. The legislative analyst in Florida, when asked to arrive at a bottom line number, came up with the following: for every dollar lost in state revenue due to the tax credits, the state saved $1.49 in foregone public school expenses. But this figure was essentially pulled out of thin air. The report's author—the legislature's "Office of Program Policy Analysis and Government Accountability" (OPPAGA)—admits as much in an appendix, "we had no information from which to estimate [the key] percentage" on which the entire fiscal savings claim is based.[2] That's right: "no information."

So Florida's OPPAGA authors guessed. And they guessed 90%—they guessed that there are nine Johns for every one Mary. The rationale for this guess is tucked away in the report's appendix. Neovouchers are available only to low-income students in Florida, so according to the report, it is "reasonable to assume a high percentage of low income students would not be able to afford private school without a scholarship, and therefore, would attend public school in absence of the program."[3]

In reality, Catholic schools in urban areas already may enroll upwards of 60% to 70% low-income children, even without a neovoucher plan in place.[4] More importantly, the low-income

families at the very head of the line to receive neovouchers will generally be those who would attend private schools even without the incentive. This means that, contrary to the report's assumptions, the relative percentages of Johns and Marys—of switchers and non-switchers—would *not* mirror the general enrollment percentages for low-income students in private schools. In fact, the report's appendix acknowledges that any fiscal advantage to the state disappears when the percentage of switchers drops from 90% to 60%. So if there's a 50/50 split between switchers and non-switchers, the Florida program would be in the red.

Some states believe that they have solved the problem by *requiring* switching. Neovoucher legislation sometimes requires that all recipients either have attended public school the prior year or that they be entering school at kindergarten (or first grade). Such a provision would have immediate results beneficial to the state's bottom line, but these benefits will disappear over time. If a neovoucher policy begins in fall of 2012, for instance, those families receiving the funding that first year would be a mix of public-to-private switchers and those entering as kindergarteners. The next year, the neovoucher recipients would be a mix of students switching from public-to-private and those entering as kindergarteners, plus the prior year's kindergarten cohort (now in first grade). Eleven years later, the "switcher" requirement would be largely obsolete. What this means is that a 90/10 starting mix can reach and surpass the 60% cost-effectiveness tipping point very quickly. The numbers might, for instance, look like this:

> *Fall 2012: 90 percent switchers + 10% entering kindergarteners*
>
> *Fall 2013: 80 percent switchers (some who whom switched in fall 2013, and some of whom had switched in fall 2012) + 10% entering kindergarteners + 10% first graders (last year's kindergarteners)*
>
> *Fall 2014: 70 percent switchers + 10% entering kindergarteners + 10% first graders + 10% second graders*
>
> *Fall 2015: 60 percent switches + 10% entering kindergarteners + 10% first graders + 10% second graders + 10% third graders*
>
> *Etc.*

The exact numbers for a given state's neovoucher policy will vary substantially, but the undeniable truth here is that the effectiveness of the switcher requirement dissipates and then disappears.

Looked at another way, we can categorize into three groups those children who receive neovouchers in a state that requires switching but also allows entering kindergarteners to receive the benefit:

(a) Those whose parents decided to switch to private school after becoming disappointed with public school;

(b) Those whose parents decided upon private school from the outset and would have never considered public school anyway; and

(c) Those whose parents decided upon private school from the outset but, in the absence of the neovoucher policy, would have sent their children to public school because private school was not affordable.

Even if legislative analysts cannot attach actual numbers to these three categories,[5] they can see that these are the *exact same three categories* that would apply in a state without a switcher requirement.

Moreover, beyond the issue of switchers, other factors are important to any determination of fiscal impact—no matter whether the neovoucher policy includes a switcher requirement. Consider the following four:

- *What is the annual cost of education in a public school?*
  If higher than the $8,000 hypothesized earlier, for instance, then the chances for state savings increase; if lower, they decrease.
- *What additional tax breaks are offered?*
  E.g., what is the cost to the state for charitable donations to the private or religious school? What is the cost to the state for any deductions given to parents for expenses on their child's private schooling?
- *Is the credit for 100% of the donation?*
  In some states (e.g., Georgia), the taxpayer-donor receives a full, dollar-for-dollar tax credit; in others (e.g., Iowa and Rhode Island) the credit is for 65% or 75%. The bottom line for the state improves as the credit percentage is decreased.
- *Does the full donation go toward vouchers?*
  Some states (e.g., Florida) require that the full amount donated be then allocated in the form of vouchers, while other states (E.g., Arizona) allow up to 10% to be used for overhead expenses. If a tax credit is provided for money that never reaches schools, the system becomes less efficient.

Less quantifiable, but also very important, are the cost implications for the larger educational system. For example, does the presence of the neovoucher policy generate inefficiencies for the conventional public school system? Or perhaps there is a competition effect on other parts of the system.

Conclusion

The financial question asked of the Florida OPPAGA and of fiscal analysts in states throughout the country now considering neovoucher legislation is an important one. But the argument that neovouchers save or cost the state a given amount of money is necessarily grounded in simple

conjecture. When a report's appendix acknowledges that it is based on "no information," we would all do well to take its conclusions with a rather large grain of salt.

Looking again at the three categories mentioned earlier, one clear conclusion is that those families in categories "a" and "c" would benefit the state financially, while those in category "b" would impose a financial hit on the state. Yet the calculation, of course, is not simply two categories versus one, since category "b" could be very large indeed. So what is a conscientious legislative analyst to do?

Recall that the OPPAGA report's appendix included information explaining how the fiscal impact on the state changes with varying percentages of switchers (e.g., 90% and 60%). That report certainly failed in other respects, but it hit the target in that one regard. Readers need to be given a range and need to understand how that range was derived.

The **key take-away point** is this: The most honest and conscientious approach to reporting the fiscal impact of neovouchers is to provide a range of outcomes and let the readers—not the legislative analysts themselves—speculate on which is most likely. If a bottom line is demanded, it should be couched in as many caveats, warnings, cautions, and limitations as can be fit on the page.

Notes and References

1 Welner, K. G. (2008). *NeoVouchers: The emergence of tuition tax credits for private schooling*. New York: Rowman & Littlefield.

2 Office of Program Policy Analysis and Government Accountability (December, 2008). *The Corporate Income Tax Credit Scholarship Program Saves State Dollars*. (Report No. 08-68.), 12.

3 Office of Program Policy Analysis and Government Accountability (December, 2008). *The Corporate Income Tax Credit Scholarship Program Saves State Dollars*. (Report No. 08-68.), 11.

4 See Hamilton, S. W. (2008). *Who will save America's urban Catholic schools?* Washington, DC: Thomas B. Fordham Institute, 25.

5 An important way to help address these issues is simply for neovoucher policies to include data collection and reporting requirements about things such as switchers, to help policy makers understand how the law is playing out. The resulting data will not be definitive, given limitations of self-reported survey responses, but they will certainly help to add an empirical basis to what is currently an area of huge speculation.

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