A257 / S1332 / S2228

Tax Credits for Contributions to "Scholarship Organizations" and "Educational Improvement Organizations"

This analysis is presented as part of an ongoing project of the Institute on Education Law and Policy entitled *Setting the Stage for Informed, Objective Deliberation on School Choice*. The project's objective is to assist the public and policy makers to make informed judgments about the role that school choice, and any particular choice program, should play in New Jersey's overall education reform efforts. Our premise is that responsible decisions about any choice program can only be made as part of broader policy decisions about the role that choice should play in public education and educational improvement. **Based on our analysis of the proposed bills, our conclusion is that the proposed tax credits would involve substantial cost to the state and affected districts, with no accountability, in exchange for uncertain educational benefit to participating students.**

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Tax Credits for Contributions to "Scholarship Organizations" and "Educational Improvement Organizations"

A257/S1332, currently pending in the New Jersey Assembly and Senate, would create a new school choice program for students in four New Jersey school districts. The bills would establish a five-year pilot to provide credits to taxpayers under the Corporation Business Tax Act for contributions to "scholarship organizations" providing aid to eligible elementary and secondary students who reside in Camden, Newark, Orange and Trenton and for contributions to "educational improvement organizations" in those school districts. **S2228,** currently pending in the Senate, would create an identical program for the four districts named in A257/S1332 as well as three additional districts, Elizabeth, Paterson and Lakewood.

This analysis of A257/S1332 and S2228 is presented as part of an ongoing project of the Rutgers-Newark Institute on Education Law and Policy, *Setting the Stage for Informed, Objective Deliberation on School Choice*. The project's objective is to assist the public and policy makers to make informed judgments about the role that school choice, and particular choice programs, should play in New Jersey's education reform efforts. Its premise is that responsible decisions about any choice program can only be made as part of broader policy decisions about the role that choice should play in public education and educational improvement. (For more of the Institute's work on school choice and other education policy issues, go to http://ielp.rutgers.edu.)

While choice in general, or any particular choice program, may have some value of its own, our concern is its impact – positive or negative – on the state's overall effort to improve public education. **Between 80 and 90 percent of all children in the state currently attend public schools, and most are likely to continue to do so even if the proposed bills are adopted. Because of this fact, the bills must be evaluated not only in terms of their potential benefit to participating students but also in terms of their potential to strengthen or weaken the public schools.**

Until 2006, the laws of three states – Arizona, Florida and Pennsylvania – authorized education tax credit programs similar to that in the proposed bills. In 2006, two more states – Iowa and Rhode Island – adopted legislation authorizing similar education tax credits.[1] There is no published research on the educational impact of such programs. A review of research on tuition tax credit programs published in 2001 by Clive Belfield of the National Center for the Study of Privatization in Education at Teachers College, Columbia University, reached no conclusion regarding impact on student achievement, but made two other findings: (1) state revenues generally fall as a result of such programs, and (2) the largest group of beneficiaries of such programs are those who already have children attending private schools.[2] Research on the educational impact of other forms of school choice, including school vouchers and charter schools, indicates that participating students receive no substantial academic benefit over their non-participating peers and that the connection between availability of choice and public school improvement is tenuous.[3] A 2006 paper by Luis A. Huerta and Chad d'Entremont, also of Teachers College, notes the contentious debate on these issues, and observes that "the political debate on tax credit programs hinges on the same divergent views for improving public education that dominate the debate on education vouchers."[4]

Without clear evidence of their educational benefit, the proposed tax credits should be evaluated on the basis of other factors, such as cost, equity and accountability, and the public school choice provisions should be evaluated on the basis of their viability. Our analysis of these factors leads to the conclusion that the proposed bills would weaken the public schools in the affected districts and disserve the students who attend those schools.

Cost. The cost of the proposed tax credits would include both the direct cost of the program, which would be substantial, and its indirect cost, measured by the affected districts' loss of state aid.

Direct Program Cost – First, we note the substantial size and cost of this "pilot." The bills would authorize tax credits – i.e., reduction in state tax revenue – in amounts not to exceed $24 million in the first year, $48 million in the second year, $72 million in the third year, $96 million in the fourth year, and $120 million in the fifth year. Even in the first year of the pilot, the authorized funding would exceed the amount of aid provided for public school choice statewide in FY 2007, including aid to charter schools and interdistrict public school choice (that amount is $23,358,000). By the fifth year, authorized funding for the tax credits would be more than five times the FY 2007 aid for public school choice.

While the program would involve tax credits rather than budget outlays, such credits would have the same budgetary effect as outlays, as they would reduce revenues and thus reduce the amounts available for spending on other items. Some of the reduction in revenues might be offset by a reduction in state spending on education, but if all the proposed scholarships were awarded to students already enrolled in nonpublic schools (as they all could be; see the discussion of eligibility below), there would be no reduction in spending to offset the reduction in revenue.

Indirect Cost – To the extent that the proposed scholarships are awarded to students already enrolled in nonpublic schools, there may be no fiscal impact on the public schools. The larger the number of scholarships awarded to students currently enrolled in the public schools, the greater the impact on the affected districts.

If the credits authorized by the proposed bills were all used for scholarships for elementary students enrolled in public schools at the time they receive the scholarships, the cost to the districts in the fifth year of the program – *i.e.*, the reduction in state aid received by the districts due to reduced enrollments – would be well over $300 million (based on the average amount of state aid received by Camden, Newark, Orange and Trenton in 2005-06, which was $16,405 per pupil).[5] The calculation is as follows:

> *Proposed scholarship amount for elementary students: $6,000 each*
> *$120,000,000 = $6,000 X 20,000 students (Year 5 program cost)*
> *20,000 students X $16,405 = $328,100,000 (Year 5 state aid reduction)*

If Elizabeth, Paterson and Lakewood are included in the calculation, the average amount of state aid received by the seven districts in 2005-06 was $14,979 per pupil (somewhat lower, primarily because of the smaller amount of state aid received by Lakewood, the only non-Abbott district in the group). Calculating the reduction in state aid based on the average per-pupil aid amount for all seven districts, the total reduction in aid in the fifth year of the program would be $299,580,000.

If half the scholarships were granted to high school students enrolled in the public schools (at $9,000 each, the maximum amount allowed in the bill for high school students), the average scholarship amount would increase to $7,500, the number of students served would decrease to 16,000, and the reduction in state aid to the four districts would be about $262 million. The calculation is as follows:

> *Average scholarship amount: $7,500 each*
> *$120,000,000 = $7,500 X 16,000 students (Year 5 program cost)*
> *16,000 students X $16,405 = $262,480,000 (Year 5 state aid reduction)*

If Elizabeth, Paterson and Lakewood are included in this calculation, the total reduction in aid in the fifth year of the program would be $239,664,000.

Of course, this reduction in state aid could be viewed either as savings for the state or as loss of revenue – indirect cost – to the local districts. Either way, it is a substantial amount. A withdrawal of 20,000 students from the four districts named in A257/S1332 would amount to about a 27 percent reduction in their K-12 enrollment (which totaled approximately 75,000 in 2005-06), and a proportionate reduction in state aid. (If all seven named districts are included in the program as proposed in S2228, a withdrawal of 20,000 students would amount to a 16 percent reduction in enrollment.) That reduction would reduce costs, but not in proportion to the loss of aid, since a significant portion of district costs are fixed costs.

The question is whether the state and the affected districts can afford both a program of private school scholarships and their ongoing efforts to provide a thorough and efficient system of public education. It is a question of budget priorities. **Maintaining a thorough and efficient system of public schools clearly should be a higher priority than private school scholarships. Considering the districts' fixed costs and, as mentioned above, the fact that the majority of students will remain in the public schools without benefit of the proposed scholarships, the program's direct and indirect costs would seem to outweigh any potential educational benefit.**

Equity. The equity considerations raised by the proposed tax credits involve the income eligibility limits, the four- or seven-district limitation, and the eligibility of students currently enrolled in nonpublic schools.

Income Eligibility Limits – Eligibility for the proposed scholarships would be limited to "low-income" students who reside in the four, or seven, named districts, with the limit set at 2.5 times the federal poverty rate, or $49,735 for a family of four, based on the 2005 poverty rate of $19,874.[6] How, or why, the income level has been set where it has, rather than lower to target the program to lower-income students, is not stated.

District Limitation – Nor is there any indication of how or why the four, or seven, districts rather than others have been selected. There is no provision for the allocation of funds or scholarships among the named districts. Without any such provision, funds apparently would be allocated based on demand. All the scholarships could conceivably be given to students from just one district.

Eligibility of Nonpublic School Students -- Eligibility would *not* be limited to students currently enrolled in public schools, and public school students would receive no priority in allocation of the scholarships. Lotteries would be required if demand for scholarships exceeded available funds, but preference could be granted to siblings of students already enrolled in participating schools, which effectively would give priority to current nonpublic school students. Thus, the great bulk of the scholarships could be granted to students who are not and never have been enrolled in the public schools. To the extent that this is the case, it would seem to be a windfall for nonpublic schools and their students, with no proportionate benefit to the public schools or their students.

Accountability – The proposed bills have no provision for accountability with respect to use of funds by "scholarship organizations" or "educational improvement organizations." There is no provision by which the state would be required, or authorized, to monitor the use of funds received by these organizations or ensure that they are used for their intended purpose. The Director of the Division of Taxation in the Department of Treasury would be required to report to the Legislature on the fiscal impact of the pilot program one year prior to its expiration, but the bills provide no authority for the Director to collect the data required to make such a report. **Especially in view of the size of the program and the amount of public funding involved, the lack of any provision for financial accountability is a serious flaw.**

The bills also would require the Commissioner of Education to report to the Legislature on the "educational merits" of the pilot program one year prior to its expiration. The Commissioner's report would be required to provide information on the performance of schools participating in the program, including pupil achievement, attendance rates, dropout and graduation rates, parental and pupil satisfaction with the program, parental involvement, and the program's "overall merit." But there is no provision authorizing the Commissioner to collect the data to be included in such a report. Nor is there any provision requiring the schools receiving scholarship funds to gather or report the necessary data, or to administer standardized tests comparable to those given in public schools. **Without such data, the program would have no educational accountability, and meaningful evaluation of the program would be impossible.**

Viability of Public School Choice Options **–** The proposed bills provide that scholarship funds may be used to cover tuition and other costs at any public or nonpublic school. However, how students may use the funds in public schools is unclear. Students in public schools that fail to make adequate yearly progress in achievement already have the right, under No Child Left Behind, to attend other public schools in their home districts free of charge. If the intent of the proposed bills is to extend that right to students in schools that are making adequate yearly progress, or to allow students to attend school in districts other than their own, that should be stated explicitly.

We suspect the reference to public schools as an eligible use of scholarship funds has been included in the bills in an effort to avoid a challenge to their constitutionality. In *Zelman v. Simmons-Harris,*[7] the United States Supreme Court case involving the school voucher program in Cleveland, Ohio, the availability of the option to transfer to public as well as nonpublic schools was one factor in the Court's decision to uphold the program, even though the option was little used. The public school provision might be intended to serve the same purpose here, but we should have no illusion that the scholarships authorized by the bill actually would be used in public schools.

Experience indicates that few suburban public school districts will volunteer to accept students from urban districts on a "scholarship" basis. No districts in Essex or Mercer counties have volunteered to participate in the state's current pilot Interdistrict Public School Choice Program. [8] We have little hope that districts in those counties would show more interest in accepting nonresident students with the proposed "scholarships." And all districts are authorized under current law to accept students on a tuition-paying basis, but few do so. If the intent of the proposed bills is to provide opportunities for students to attend public schools in districts other than their own, districts should be required, rather than merely permitted, to accept nonresident students. The bills do not do so.

Finally, the "educational improvement organizations" would distribute funds as grants to public schools in the four, or seven, named districts for "innovative educational programs." An "innovative educational program" is defined as "an advanced academic or similar program that is not part of the regular academic program of a public school but which enhances the curriculum or academic program of the school." The need for, or benefit of, grants for such extracurricular programs is at best unclear. The advice of the affected districts as to the need or potential benefit might be helpful. If the districts do not support such programs, or few if any "educational improvement organizations" are likely to come into existence, the provision for tax credits for contributions to such organizations might be as illusory as the use of "scholarships" in public schools.

In any event, the Legislature should not act on any proposal involving public school choice without giving further consideration to reauthorizing the Interdistrict Public School Choice Program. The Institute on Education Law and Policy has conducted an evaluation of that program for the Commissioner of Education and the Legislature's Joint Committee on the Public Schools. (For a copy of the report of that evaluation, go to http://ielp.rutgers.edu.) The Legislature should consider the important policy issues raised in that report in connection with any discussion of the public school choice provisions of the proposed bills.

In sum, there is little or no evidence of positive educational impact of programs such as that proposed in the bills, and little indication that the bills, if enacted, would make a positive contribution to education reform efforts currently underway in the seven affected districts and the state as a whole. The proposed program would offer scholarship opportunities that might not otherwise be available, but it would not provide a meaningful opportunity to test the merit of this form of school choice. Our conclusion is that the program would involve substantial cost to the state and affected districts, with no accountability, in exchange for uncertain educational benefit to participating students.

ENDNOTES

[1] Ariz. Rev. Stat. 43-1183 (Arizona); Fla. Stat. § 220.187 (Florida); I.C.A. § 422.11M (Iowa); 24 P.S. 2001-B *et seq.* (Pennsylvania); R.I.L. 2006, c. 246, R.I. Gen. Laws § 44-62-1 *et seq.* (effective Jan. 1, 2007) (Rhode Island).

[2] Clive R. Belfield, "Tuition Tax Credits: What Do We Know So Far?" (National Center for the Study of Privatization in Education 2001), http://www.ncspe.org. For further information regarding research on education tax credits and other forms of school choice, see the websites of the Heritage Foundation, http://www.heritage.org/Research/Education/SchoolChoice/SchoolChoice.cfm, and People for the American Way, http://www.pfaw.org/pfaw/general/default.aspx?oid=12074. Arizona's tax credit program has been the subject of more research than that of any other state; *see* Carrie Lips and Jennifer Jacoby, *The Arizona Scholarship Tax Credit: Giving Parents Choices, Saving Taxpayers Money* (Cato Institute 2001), http://www.cato.org/pub_display.php?pub_id=1273 (analyzing the fiscal impact of the Arizona tax credit program but not addressing the program's educational impact on participating students or public schools in their districts of residence); Kevin G. Welner, *Education Tax Credits: No Net Benefit to Arizona's Impoverished Students* (Education Policy Studies Laboratory, Arizona State University 2003), http://epsl.asu.edu/epru/documents/EPRU%202002-110/epru-0203-110.pdf (finding that the program then in effect did not "provide equity or improve achievement for impoverished students currently enrolled in the state's public education systems"). The Arizona law was amended in 2006 to, among other things, add an income eligibility limitation for scholarship recipients. Ariz. L. 2006, c. 325, codified at Ariz. Rev. Stat. 43-1183.

[3] For a comprehensive review of research on the effects of choice, particularly school vouchers, on student achievement, *see* Clive R. Belfield, *The Evidence on Education Vouchers: An Application to the Cleveland Scholarship and Tutoring Program* (National Center for the Study of Privatization in Education 2006), http://www.ncspe.org/publications_files/OP112.pdf. *See also* Chris Lubienski and Sarah Theule Lubienski, *Charter, Private, Public Schools and Academic Achievement: New Evidence from NAEP Mathematics Data* (American Education Research Journal Winter 2006), http://www.ncspe.org/readrel.php?set=pub&cat=126. For a discussion of the effects of choice, particularly charter schools, on traditional public schools, *see* Richard Buddin and Ron Zimmer, *Is Charter School Competition in California Improving the Performance of Traditional Public Schools?* (RAND Corporation 2005), http://www.rand.org/pubs/working_papers/2005/RAND_WR297.pdf .

[4] Luis A. Huerta and Chad d'Entremont, "Education Tax Credits in a Post-*Zelman* Era: Legal, Political and Policy Alternatives to Vouchers?" http://www.ncspe.org/readrel.php?set=pub&cat=158, to be published in *Educational Policy*, 2(1), January/March 2007.

[5] *See 2006-07 State Aid Summaries*, http://www.state.nj.us/njded/stateaid/0607/).

[6] *See* http://www.census.gov/hhes/www/poverty/threshld/thresh05.html).

[7] 536 U.S. 639, 122 S.Ct. 2460, 153 L.Ed.2d 604 (2002).

[8] Districts in Camden, Passaic, Ocean and Union counties accepted students under the Interdistrict Public School Choice Program in 2005-06 in the following numbers:

County	District	Choice Students
Camden	Brooklawn	67
Ocean	Stafford Twp.	5
Passaic	P.C. Manchester Reg.	14
Union	Kenilworth	101