# Diversity & Choice or Regulation & Monopoly?

Posted by Adam Schaeffer

Stephanie Saul's anecdote-driven smear piece in yesterday's NYT has perhaps had one positive effect; a serious discussion of good education tax credit bill design.

John Kirtley, chairman of the only active scholarship organization in Florida and father of the state's credit program, used the NYT piece as a jumping-off point for legislative guidelines. Kirtley has done tremendous things in Florida for low income children and educational choice, but several of his policy recommendations (shared by others) are either unsupported or contradicted by the evidence.

I'll use Saul's brief description of the positive aspects of Florida's credit program (which Kirtley praises) and his own guidelines as a structure for discussion. (See here for legislative guidelines and model legislation.)

**Academic and Fiscal "Accountability"**

This is the area in which the guidelines proposed by Kirtley and organizations such as the American Federation for Children are most at odds with research on education markets and government regulation. For decades, policymakers have desperately tried to improve education through accountability to the government. Their efforts have clearly failed. And it would be disastrous to involve the government, which has failed so dismally for so long, more directly in the private education sector and the private decisions of families and taxpayers. As Neal McCluskey showed for Florida specifically, fraud, waste and abuse in the public education system is much more widespread and pervasive than in private school choice programs.

Below are the reasons it is unnecessary and harmful to increase government regulation on education decisions made by families and taxpayers.

Education tax credits automatically impose three layers of accountability; 1) The *parents* who choose the school, 2) the *scholarship organization* that provides funds to parents, and 3) the *taxpayer* who donates or directly spends their own money on education. Additional government regulations are therefore unnecessary and interfere with the choices of those directly affected by the program.

Andrew Coulson's international literature review of the school choice/education market research shows that the least regulated education markets had the greatest margin of superiority over state school systems.

The use of vouchers, as government funds, can only be held accountable to the taxpayers whose money is used through the government, which disburses those funds. By contrast, credit funds are private funds, disbursed to students or scholarship organizations directly by the taxpayers who earned them. *There is already direct accountability to the taxpayers* who fund the credit program.

In short, no new requirements for or regulations on private schools or home schooling should be imposed. If accreditation is not required for existing private educational options, then none should be imposed on private choices backed by private credit funds.

**Scholarships are strictly controlled to make sure they go to poor families.**

All other donation credit programs besides Georgia are means-tested.

However, there are serious problems with hard income cut-offs for any program meant to help those who need help. What about the family that has a child with special needs, perhaps not rising to the level of an IEP, but requires more resources than a typical child? Or the family that loses one income earner, but can't qualify because of their most recent tax return?

In a decentralized credit scholarship system, such flexibility can be built into means-testing regulation. In New Hampshire, scholarship organizations are allowed to use up to 20 percent of their funds for families who fall outside the strict income cutoff.

Strict, hard income cutoffs may be easy for governments and large organizations to process, but they come at a serious cost in flexibility and responsiveness to the diverse needs of individual children and families.

**Only corporations are eligible for the tax credits.**

Individual-level tax credits are relatively difficult in Florida because there is no individual income tax. However, sales tax credits can be allowed for individuals at the point of sale.

From a larger perspective, however, this is an unfortunate flaw, not a feature, and including individual taxpayers is a huge positive for any program.

Corporate tax liabilities are subject to very large fluctuations year-to-year, there are far fewer corporate than individual taxpayers, and decisions must be made within an often-complex and time-consuming process.

All of this means that *corporate-only credit programs are more volatile, uncertain, and costly.*

Donations from individual taxpayers broaden and stabilize the revenue stream for credits, invest real human beings in supporting education with their personal funds, and thereby create greater accountability to a more diverse and attentive donors base.

**Eliminating the chance of parents donating for their own benefit.**

The problem of parents donating for the benefit of their own child is an issue created by poor policy design in the first instance.

What sense does it make to force parents with a tax liability, who also need assistance for their child, to 1) donate to a scholarship fund and then 2) apply to that non-profit for a scholarship *funded with the money that they earned and donated in the first place*?

This absurd circular-donation system can be easily fixed by allowing parents to claim a credit for their own child's education—as is already done in Illinois and Iowa. It can be made even better by allowing grandparents, uncles, aunts, friends, and neighbors to claim a credit for money they spend on a specific child they know and want to help. Allowing those with a direct personal interest in the success of a child to help support their education creates yet more accountability and more direct involvement in education from extended families and communities.

**All scholarships are handled by one nonprofit organization, and its fees are limited to 3 percent of donations.**

Florida's education tax credit program is run entirely by a single non-profit organization largely due to the fact that scholarship organizations are not able to use any credits funds for the significant overhead involved in running such an organization for the first three years, and then only 3 percent thereafter, which is inadequate for meeting reasonable costs.

This hyper-centralization is the single most concerning flaw in Florida's education tax credit program.

Taxpayers have no choice among scholarship organizations, and therefore their only choice if they are unhappy with the current SO is to not donate money to support needy children at all.

By all accounts, the single SO in Florida is a model non-profit. However, what happens should the current leadership move on or pass away? The character and performance of large organizations does not continue in perpetuity, and the evidence on the performance of monopolies long-term is grim indeed.

In the case of malfeasance or even an innocent but serious mistake at this single scholarship organization, the results could be devastating. Without other SOs to turn to, allowing donors to immediately de-fund the underperforming SO in favor of better ones, there will be intense political pressure to shut down or take over the system. Indeed, even absent a scandal, the centralization of all scholarships in one SGO makes it a tempting and easy target for state takeover.

Furthermore, is it wise or right in a larger sense for a single, private non-profit to control and administer hundreds of millions of dollars, potentially more than $1 billion within seven years, on behalf of tens of thousands of children and all the taxpayer who want to help them?

A diverse array of scholarship organizations ensures beneficial competition among non-profits, provides choices to families and taxpayers, and allows the development of organizations more intimately connected with and integrated into local communities and more flexible and responsive to the needs of individual families and children.

**Parents – not individual schools or scholarship organizations – should own the decision of where their children attend school. In Florida, the scholarship can be used at any one of the 1,350 private schools whose participation has been approved by the state.**

The centralized bureaucracy of Florida's education tax credit program means that taxpayers have no choices in directing their money where they think it will do the most good, and families have no choices of scholarships organizations to which they apply.

In this situation, there is little choice but to standardize the process and ensure equal access with no regard to the quality of the school or need of the child beyond the statutory minimum. Indeed, should the sole scholarship organization decide to make distinctions – even reasonable, well-intentioned distinctions – among schools or applicants, they would be vulnerable to charges of unfair treatment because there is literally no alternative in the state.

The diversity of scholarship organizations in other states means that taxpayers and families can choose to work with organizations and schools they think perform well and comport with their values. Taxpayers and families in Florida are not afforded those options, and taxpayers are forced to fund all schools chosen by families, from good to bad and from fundamentalist Christian to Catholic to secular liberal if they wish to participate in the program at all.

Parents and taxpayers should have a diverse array of choices, and a large and diverse collection of scholarship organizations is essential for achieving that.

Adam Schaeffer • May 24, 2012 @ 8:43 am
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# School choice movement can’t give grenades to opponents

By John Kirtley
On May 24, 2012 in Education and Public Policy, Education reporting, General, School Choice

*Editor’s note: Tuesday’s New York Times story about tax-credit scholarship programs sparked a flurry of reaction from leading school choice supporters, including John Kirtley, who chairs Step Up for Students, the non-profit that administers the tax credit program in Florida. In a blog post today, the Cato Institute’s Adam Schaeffer took exception to some of the guidelines Kirtley proposed for other state programs, and also raised concerns about what he calls the “hyper-centralization” of Florida’s program. Here is Kirtley’s response:*

First, I want to thank Adam Schaeffer of the Cato Institute for his engaged dialogue on the vital subject of tax credit scholarship program design. I also want to say that I have been an admirer of Cato for over a decade, and even attended its wonderful “Cato University” in the late 1990’s.

The main point of my response is this: as someone who is trying to pass, grow and protect parental choice laws in Florida and across the country, I live in the real world of legislation and politics. We are trying to change something that has been the same for 150 years. Those who don’t want change are extremely powerful, well-funded, and have willing allies in the press. We have to fight hand-to-hand legislative and political combat state by state. And we can’t hand our opponents grenades with which to blow us up.

Adam is absolutely correct that you can only drive so much excellence through top-down accountability. Our scholarship organization’s president, Doug Tuthill, and I constantly talk about the “new definition” of public education we would love to see — a transformation from “East Germany” (pre-Berlin Wall fall) to “West Germany.” We see a system where end users allocate resources and choose among many providers and delivery methods – public or private. Of course I understand, as Adam asserts, that such a system will produce better results. I’m a businessman! Or at least I used to be, before this movement took most of my time. But we can’t wave a magic wand and create that transformation overnight. And as in any free market system, there is a role — though many will argue over the extent – to be played by government.

Adam points out there is more fraud and waste in public schools than in scholarship programs. So what? We’re held to a higher standard. It’s not fair, but it’s a fact. In Florida, when stories of public school teachers having sex with students was the topic of Letterman and Leno monologues, one of the most respected newspaper columnists in Florida blasted vouchers because a private school principal took a bunch of young girls unsupervised to Disney World. There weren’t even any scholarship kids at the school. Another newspaper called for the repeal of the tax-credit program because (among other things) not every school had submitted documentation of their fire inspections. At the same time, the Orlando Sentinel (to its credit) ran an article about public schools in the area that were so out of fire code they had to hire fire marshals to stand watch at them. No one called for those schools to be shut down.

The point is we operate in a zero tolerance environment in Florida. Opponents to choice are desperate for examples that the program isn’t being operated properly. They would love to find a family that makes too much money to qualify, or to learn household incomes or sizes weren't documented properly. And it would hurt us if they did.

The Florida program almost died in its infancy because of the actions of some scholarship organizations. One was run by a former drug dealer who — after receiving a donation from a company by mistake — promptly used it to pay overdue bills for his correspondence school. Front-page story in the press. Another group gave out scholarships they didn't have the money for. There are other examples that I won't take the time to cover here. The Florida environment wouldn't tolerate more than 200 scholarship groups taking a 20 percent administrative fee. If our press found problems when there were only seven groups, how many would they find with 200, especially with the lack of regulations Adam proposes?

There is no "mandated monopoly" in Florida's program. We are the only operator because we are the only survivor. Should we be fortunate to grow to 150,000 students and close to a billion dollars, as Adam predicted, it will be because we operate with zero defects in this demanding environment. Though I am biased, I have a hard time believing there is more risk to the program's growth by our "market share" than the risk posed by having more than 200 groups involved.

I seem to recall that Cato didn't approve of the government's investigation of IBM and Microsoft's "monopolies." Time proved that disapproval prescient. Anyone can start a scholarship group here. For a while they did, and the results weren't pretty.

Adam raises concerns about means testing. This topic is always under discussion within our movement. I respect the universalist position, but I didn't dedicate myself to this movement to help people who can already make a choice for their kids. Because of political and constitutional constraints in Florida, we can't offer a voucher program with wide eligibility. According to the Florida Department of Education, 56 percent of our kids qualify for free or reduced Lunch — that's almost 1.5 million children. That's probably high because they don't have to document household size and income like we do. But let's say it's a million kids. We can't serve all of those kids now, not by a long shot. We can't even serve all the poor families who are currently interested. Who would you kick out?

Adam says individual tax credits are "relatively difficult" in Florida, since we have no state income tax. Yes, I'll say. To his credit, Adam brainstormed the idea of trying to capture the huge sales taxes individuals pay, which should pass constitutional muster. Ironically, the only way this idea could ever have a chance of being implemented is if a few big retailers worked with one large scholarship provider.

I have nothing against individuals getting a tax credit for their own children's private school tuition. But that's a different policy objective. Poor families don't pay enough in state taxes for that amount to empower them. I have no problem with individuals getting a credit for giving to scholarship funds. Of course not! What I do have a problem with is people being able to restrict donations to a single student, a single school, or a single religion.

The IRS doesn't allow donations to be earmarked to a single student, so that's settled. Why not allow a school-focused fund? My motivation is to empower low-income and working-class parents to pick the best school for their kids, and to choose from all qualified schools. Laws allowing single-school scholarship-funding organizations allow the schools who are best at fundraising to garner more funds, and scholarships aren't portable. What if the school isn't a fit for a kid? Too bad. What if an inner-city school with a 95 percent graduation rate isn't a good fundraiser? Too bad, kids can't go there. Single-school programs can end up being excellent tuition assistance programs for schools, but not parent empowerment programs. Again, perhaps admirable, but a different policy objective.

Why not a single-religion scholarship fund? I know the U.S. Supreme Court says it's okay for a fund to discriminate by religion, but is it smart for the movement if this happens? What if the Catholic fund raises most of the money? Or the Jewish fund? Or, to play out choice opponents' dreams, the Muslim fund? Do you think the capable (some may say ruthless) opponents to choice won't make the most of such an occurrence? Even Hillary Clinton played the Muslim card in justifying her objection to parental choice. Do you really think that legislators are strong enough to deal with a front-page story about that?

There are states, like Arizona, where the political and press environment are such that a scholarship program can exist with little regulation (though even the pro-choice Arizona Republic blasted the program for its abuses). But if the movement hopes to spread choice to a large number of states, a *laissez faire* approach will fail. I will be very interested to see if the Georgia program grows, now that it has reached its initial cap. The *New York Times* hit piece is already being used to fight the effort to pass a bill in North Carolina. Will it kill it? I don't know, but it's sure not making it any easier. That's the real world parental choice advocates live in.

Source: [http://www.redefinedonline.org/2012/05/school-choice-movement-cant-give-grenades-to-opponents/#more-5964](http://www.redefinedonline.org/2012/05/school-choice-movement-cant-give-grenades-to-opponents/#more-5964)

# Tax Credit Policy Design for School Choice: A Response to John Kirtley

Posted by Andrew J. Coulson

There are few people with whom I am so much in agreement on the goals of education policy as John Kirtley. To the extent that we differ, it's chiefly about the best ways of achieving those shared goals. With that in mind, here are my thoughts on his recent post on Education RedefinEd.

### Regulation of Private Schools under Education Tax Credit Programs

I've no reason to think that the customary financial reporting requirements imposed on scholarship-granting organizations (SGOs) are problematic, but the same cannot be said about regulations imposed on the private schools themselves. In response to an earlier post by Adam Schaeffer, John writes that "Adam is absolutely correct that you can only drive so much excellence through top-down accountability." But Adam actually goes further, arguing that there is no evidence you can drive *any* excellence through "top-down accountability" (read: "government regulations") on private schools. The purpose of noting the corruption in state schools (e.g., in Florida and Atlanta) is to show that even the vast array of government regulations imposed on public schools fails to curtail such defects. And, as I found in reviewing the worldwide literature comparing different types of government, pseudo-market, and market education systems, it is the *least regulated, most market-like systems* that consistently do the best job of serving families across all measured outcomes.

If there were compelling evidence that government regulations on schools could reduce corruption or boost academic achievement, there might be a case for such regulations being added to tax credit programs. But no such evidence exists to the best of my knowledge. In addition to failing to achieve its intended goals, regulation inhibits the educational freedom and diversity that are responsible for the market's efficiency and responsiveness to families—undermining the whole purpose of a choice program.

The one and only empirically defensible argument in favor of regulations of schools under tax credit programs is political: in some states, it may not be possible to enact tax credit programs without such regulations. In that case, a judgment call has to be made on whether the regulations are so bad as to compromise the program and make it unworthy of passage, because it would fail to produce positive results and give the movement a black eye that would mistakenly be carried over to better, freer programs.

But that argument does not apply to states that have already enacted relatively free school choice programs, by definition: the bills have already passed, so the regs weren't politically necessary.

### Multi-SGO vs. Single SGO Tax Credit Program

John also argues that a proliferation of SGOs increases the risk of a financial or other SGO scandal in any given year. It's a plausible argument. If the probability of a scandal breaking out at any one SGO is fixed, and that probability is equal to $x$, then the probability of a scandal breaking out at any one of a group of SGOs would be = $1 - (1 - x)^N$, where $N$ is the number of SGOs. As $N$ goes up, so does the likelihood of at least one scandal occurring.

On the other hand, it seems likely that the probability of a scandal breaking out at an SGO is *not* fixed, but rather is proportional to the number of people the SGO employs. Hiring more people raises the chance that you eventually hire someone crooked. Tempting as it is to develop a full-blown mathematical model for scandal risk based on the number and size of the SGOs, it seems sufficient to say that the two factors probably cancel each other out to a considerable extent. In other words, it is not obvious that scandal risk would be appreciably different in single SGO vs. multi-SGO environments.

But the absolutely crucial factor that the above discussion omits is that the *impact* of a scandal *also* varies with respect to the number of SGOs. If you have 200 SGOs, each of limited size, and one of them has a scandal, it's no big deal. Donors will just stop giving to that SGO and it will go out of business unless it manages the Herculean task of convincing the public it has mended its ways. Parents that had gotten scholarships from it will then seek scholarships from one of the SGOs that is now receiving the donations that the corrupt one used to get. In fact, this is just what would have happened in the case of the errant donation that John mentions, whether or not any new regulations were imposed.

Indeed, we see this with charities in general. Charitable giving is hugely popular in the United States, but every year some charities are found to be fraudulent or mismanaged. This has had little or no effect on the popularity of charitable giving over time. The system has proven extremely resilient as former donors to the fallen charities have simply shifted their giving to better-run institutions. There has been no move to winnow down America's charitable landscape either overtly or indirectly (such as by drastically limiting the share of donations that can be used for operational overhead, and thereby driving most institutions out of business).

John likens the probability of a scandal at an SGO in a multi-SGO tax credit program to "giving the enemy a hand grenade." Extending that simile, the single SGO model is like giving opponents a nuclear time bomb. What happens if there is only one SGO that accepts all the donations in a state and it succumbs to a scandal? Donors have nowhere else to turn. Many will likely stop donating and poor families who were depending on those scholarships will suffer. That, in turn, will not sit well with legislators or the public, who would likely act to re-open the flow of funds to those families.

But how would they go about trying to do that on short notice? One way would be for the state to take over the corrupt SGO and promise to set it aright. As we've seen, state control of education does not prevent scandals, so that won't work—but it would destroy the independence of the program. Another alternative would be for the state to create its own SGO alongside the corrupt one, with much the same effect. Yet another option would be for the state to impose a passel of new regulations on the corrupt SGO, promising that these would solve the problem—which, as we've seen, they'd be highly unlikely to do. And finally, the state could simply shut the program down entirely, forcing all those families back into the state school monopoly, which they had deliberately chosen to flee. Every one of those outcomes is far worse than the outcome in a state with many SGOs. Indeed, *even without a scandal*, a single-SGO system represents a vastly easier and more tempting target for a state takeover than a distributed, multi-SGO system.

I am both very happy and very relieved to grant that John's organization, Step Up for Students, is impeccably run and is not likely to suffer a scandal in the foreseeable future. But, as Adam asks, what happens if/when John and the organization's current top executives are gone? And similarly, what happens in states that don't have a John Kirtley to create and brilliantly staff and oversee their one and only SGO? I've been around long enough to know that John Kirtleys do not grow on trees. The school choice movement is astonishingly lucky to have him as one of its leading lights. And because of the rarity of his invaluable qualities, it is unwise to design a policy that relies on similarly exceptional individuals to lead every SGO in every state in perpetuity.

Some SGOs will inevitably be overseen by less experienced, capable and honorable people (just as some public school districts are today) and so our education policies must systematically minimize the damage that mismanagement and corruption can do. Giving donors real choice among a panoply of different SGOs is the only mechanism yet suggested to accomplish this task, and one that has proven its value for generations in the broader charitable sector.

**Preserving Parental Choice**

There is another important reason to prefer the multi-SGO model, a goal that John and I deeply share: preserving real parental choice. A central conclusion of my journey through education history from classical Greece to modern America, England, Canada and Japan was that parents generally make better choices for their own children than even "expert" third parties make on their behalf. That is true whether the third parties are government bureaucracies or private institutions. And in my reading of that history I failed to find a single education system in which third parties who were paying for children's education indefinitely restrained themselves from shaping what or how those children were taught. Ultimately, the money came with strings attached. (The G.I. Bill, sometimes presented as a counterfactual to this observation, is actually not relevant, since the pattern I'm describing is for elementary and secondary education. It is when children are young and their minds most malleable that the temptation is greatest to shape them in whatever image the third party wishes.)

We'd be wise to expect that pattern to continue. But if all third party payment ultimately comes with strings, how do you preserve the maximum level of parental choice? You prevent any single individual or organization from gaining a monopoly in third party education subsidies. By ensuring that a multiplicity of funding sources exists, you make it possible for parents to seek assistance from whichever organization most closely comports with their needs and preferences.

The freedom of donors to give to different SGOs that match their different educational ideals thus offers unique protection to families against being forced to accept strings they object to.

The alternative John suggests, legislatively forbidding SGOs from attaching any conditions to their scholarships, is unlikely to achieve its intended aim in the long run. Certainly there is no precedent for it, and it is easy to think of cases that would undermine it. What happens when schools begin to open that refuse to serve gay students? Or that exclusively serve them? What about Wiccan schools? What about “Marx’s Manifesto Middle School”? What about “Hayek High”? For each one of these schools, there is a distinct and sizable constituency that would deeply object to funding it. So what happens if all SGOs have to fund all of them? Do angry, coerced donor/taxpayers roll over and go gently into that good night of compulsion? No. They demand that their representatives impose restrictions on the eligibility criteria for private schools. But since we live in a pluralistic society, that ultimately will result in a gradual accretion of homogenizing restrictions on the kinds of education schools can offer, winnowing down the range of choices available to families—precisely the opposite of the intended goal.

Nor is this merely a hypothetical. I suspected this phenomenon would exist based on my research for *Market Education: The Unknown History*, but recently tested it statistically by comparing the level of regulation imposed on private schools under voucher versus education tax credit programs. Under vouchers, every taxpayer is compelled to pay for every government-approved private school. Under tax credit programs (with the partial exception of Florida’s) donors have very broad latitude in choosing the kind of SGO they will support, and SGOs have similar latitude. So, based on my theory, we would expect vouchers programs to result in more heavily regulated private schools than tax credit programs because of the compulsion that vouchers perpetuate but tax credits avoid. After crunching the numbers using two different statistical methods and allowing for thousands of different randomized ways of measuring regulatory burden, I found that vouchers do impose a large and statistically significant extra burden of regulation on private schools that tax credits do not. This evidence is not dispositive, but it is consistent with the analysis outlined above, and it’s the only evidence we have. I suggest that we ignore it not so much at our own peril as at the peril of the children we seek to serve.

**One Model to Rule Them All?**

In any discussion of the “best” policy, I think it’s wise to consider the possibility that any one of us (or even all of us) could be wrong. Education policy is hard. We can of course do our best to collect the widest possible body of relevant evidence, and to test our recommendations empirically whenever possible. We can and should have more discussions like this one, which are hugely valuable. But after all that, we could still be missing something.

Given that reality, there is one other step we can consider to maximize our chances of getting education policy right: we can let different models coexist side by side for a few decades and watch how well they perform, rather than trying to homogenize them up front. If one program doesn’t work quite as well as another, we will see that and be able to learn from it. But if we insist on conformity in the short term, we may never learn those important lessons. And if we settle on a fundamentally flawed model, the results could fall very far short of our hopes and expectations.

Of course, in any state that is just adopting a school choice program for the first time, there has to be a decision as to which program is best. But in states where programs have already been implemented, it seems far wiser to allow them to mature independently rather than to try to “fix” them or even supplant them with new and different programs simply because we believe that they may suffer shortcomings in the future.

Almost anything is better than the status quo monopoly, and yet we've had this awful monopoly for a century and a half. It's hard to correct mistakes once a policy monoculture has established itself and crowded out the alternatives.

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