Breaking Down “Earning Full Credit”

Jason Bedrick

June 1, 2015

Indiana is a national leader in school choice. Hoosier policymakers deserve credit for adopting innovative policies that help families enroll their children in the schools that work best for them. In addition to the nearly 30,000 students who received school vouchers last year, more than 11,000 students used tax-credit scholarships to attend schools of choice, which saved Indiana taxpayers more than $23 million.

However, as I’ve detailed in a new Friedman Foundation report, *Earning Full Credit*, the Indiana School Scholarship Tax Credit program is limited both in terms of the number of students who can benefit and the degree to which they can benefit.

To earn full credit, Indiana should expand and improve the tax-credit scholarship program to serve even more students and serve them better. If Indiana lawmakers enacted the report’s four proposed changes, the state could quadruple the amount of tax-credit scholarships issued annually by 2024–25 and empower families to better tailor their children’s education to their unique needs—all while saving Indiana taxpayers an estimated $137 million cumulatively over the course of the decade.

Toward Universal Educational Choice

In 2009, Indiana became the seventh state to enact a tax-credit scholarship (TCS) law, which brings together businesses, taxpayers, and nonprofits to expand educational choice and opportunity. There are currently more than 200,000 students participating in 18 TCS programs in 14 states, not including two enacted this year in Montana and Nevada. TCS laws grant tax credits to individual and/or corporate taxpayers who contribute to nonprofit scholarship-granting organizations that help low- and middle-income families send their children to the schools of their choice. Indiana's TCS law provides credits worth 50 percent of eligible donations, which is tied with Oklahoma's for the lowest credit value in the nation.

As of the 2014–15 school year, Indiana capped the total amount of tax credits available to $7.5 million, which is less than 0.07 percent of Indiana's $11.5 billion in spending on public education. Earlier this year, Indiana lawmakers raised the tax-credit cap by $2 million over two years, which could provide similarly sized scholarships for just shy of 4,000 additional students.

While that's certainly a step in the right direction, it falls far short of demand. According to a 2011 Friedman Foundation survey, 41 percent of Indiana parents would choose a private school for their children if they could afford it. That's significantly more than the 9 percent of Indiana parents who current enroll their children in a private school. There are likely more than 100,000 scholarship-eligible students whose parents would like to send them to a private school yet do not do so. Although Indiana recently expanded its school voucher program, some students qualify for tax-credit scholarships but not vouchers, and some families would like to choose schools that accept the scholarships but eschew the vouchers due to the corresponding regulations.

There are three concrete changes policymakers can make to expand the number of students who may receive tax-credit scholarships:

1. Double the total amount of tax credits available next year.

2. Add an "escalator clause" that would automatically raise the tax credit cap by 25 percent in each subsequent year.

3. Raise the tax credit value from 50 percent of contributions to 75 percent in order to encourage more contributions.

Immediately doubling the amount of available tax credits and adding a 25 percent escalator clause would lift the cap to nearly $112 million after a decade. Although that sounds like a lot, it's barely 1 percent of what Indiana currently spends on public schools.

Of course, raising the credit cap would not guarantee enough donors to claim all the credits. Indiana donors have only recently come close to hitting the $7.5 million cap whereas several states with 100 percent credit values consistently hit credit caps that are significantly higher per capita. Raising the tax credit value to 75 percent would encourage more giving, which translates into more scholarships.

If Indiana were to adopt these proposed changes, after a decade there would be sufficient funds to provide 45,000 students with scholarships worth $2,500 (more than double today's average of about $1,000). Moreover, Indiana taxpayers would save approximately $137 million cumulatively over the course of the decade.

From School Choice to Educational Choice

In addition to expanding access to scholarships, Indiana policymakers should consider expanding how the scholarships can be used.

At present, Indiana families can only use tax-credit scholarships to cover private school tuition. However, not all education takes place in a traditional school setting. Increasingly, parents are turning to alternatives like online courses, tutoring, "micro-schools," and homeschooling to educate their children—options that are not yet covered by Indiana's tax-credit scholarships.

Some states are embracing the changes in how education is delivered by changing how education is funded. Five years ago, Arizona enacted the first education savings account (ESA) program, in which the state deposits funds into private bank accounts that parents can use to purchase a wide variety of educational products and services, including tutoring, textbooks, online courses, or educational therapy in addition to—or instead of—school tuition. Since then, Florida, Mississippi, and Tennessee have all enacted ESA programs for students with special needs and legislatures in a dozen other states considered doing the same.

Likewise, tax-credit scholarship recipients in New Hampshire can either use their funds for private school tuition or a variety of homeschooling expenses. Indiana policymakers could improve upon the New Hampshire model by allowing families to combine the two approaches by enrolling their children in private school *and* taking advantage of online courses, tutoring, and more.

Expanding the uses of the scholarship funds in that way would allow parents to better tailor their children's education in whatever educational environments work best for them. By focusing education funding on students' learning needs rather than institutions, Indiana will foster a more innovative and student-centered education system.

Earning Full Credit

Indiana's tax-credit scholarship program is a win-win-win. It's a win for students who gain access to educational opportunities that would otherwise be out of reach. It's a win for taxpayers who spend less per pupil for the same or better outcomes. And it's a win for communities where all children, no matter their parents' income, have greater access to a diverse array of learning options.

Nevertheless, the Indiana School Scholarship Tax Credit is not living up to its full potential. The severe cap on the amount of available tax credits limits the number of students who can benefit, and restrictions on how recipients can use the scholarship funds limit how those students can benefit. By adopting the changes proposed in *Earning Full Credit*, Indiana will be able to serve more students and serve them better.

It is impossible to predict how students will be educated in the Information Age. If states want their students to access the full range of possibilities just over the horizon, they must rethink their antiquated funding mechanisms. As those possibilities become realities, expanded-use tax-credit scholarships can empower parents to leverage those innovations to customize their children's education. Indiana could lead the way.

Jason Bedrick is a Policy Analyst at the Cato Institute.