

# NATIONAL AFFAIRS

## The Next Step in School Choice

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School choice has been one of the great successes of the education-reform movement in recent years, and taxpayer-funded vouchers have been one of the movement's primary tools. Vouchers enable students and their parents to use public funds to choose the school that is best for them, freeing them from the monopoly that neighborhood public schools have had for decades.

Milton Friedman, considered the father of the modern school-choice movement, first proposed the concept of school vouchers in 1955. By introducing consumer choice into education, he argued, vouchers can help create a competitive marketplace: "Vouchers are not an end in themselves," Friedman wrote in 1995; "they are a means to make a transition from a government to a market system."

Friedman was likely even more innovative than education-reform advocates realize, because he saw that a real education market would create its own path, pushed along by market forces. Noting in 2003 that "there's no reason to expect that the future market will have the shape or form that our present market has," Friedman wondered: "How do we know how education will develop? Why is it sensible for a child to get all his or her schooling in one brick building?" Instead, Friedman proposed granting students "partial vouchers": "Why not let them spend part of a voucher for math in one place and English or science somewhere else?...Why can't a student take some lessons at home, especially now, with the availability of the Internet?"

Education savings accounts operate like the "partial voucher" that Friedman envisioned more than a decade ago, allowing families to seek out the best educational opportunities for their students — whether those be in a private or parochial school or a mix of non-traditional education options. Two states have already adopted ESAs, and numerous other state legislatures have considered them. ESAs constitute a critical refinement of Friedman's voucher idea, moving from *school* choice to *educational* choice. The challenge for state policymakers is to overcome implementation issues, avoid constitutional roadblocks, and resist harmful regulations masquerading as "accountability."

### SAVING AND CHOOSING

As the first ESA program to be implemented in the United States, Arizona's Empowerment Scholarship Accounts offer a useful example of how the accounts can work in practice. Under the Arizona law, passed in 2011, eligible families that opt not to enroll their children in a public school full time can access 90% of what the state of Arizona would have spent on their children if they had enrolled in the public-school system. The Arizona Department of Education deposits

funds directly into a privately managed bank account, and parents can access the funds through a restricted-use debit card. The parents can then spend the money on any qualifying education-related service or provider they choose.

Child-specific factors determine the amount of money distributed into a family's ESA. Children assigned to underperforming schools, from active-duty military families, or in foster care received approximately \$2,800 per year (90% of the state per-pupil base-level allocation of roughly \$3,100) during the 2011-12 school year. An expansion in 2013 included additional state expenditures as a part of the total used to calculate the award amount, increasing the average non-special needs ESA award to \$5,300. Children with special needs, meanwhile, received significantly larger distributions, weighted according to their disability, with at least one receiving \$28,000 during the first year of the program.

Funds are deposited quarterly into a student's ESA and can then be used to pay for private-school tuition, online learning, special education services and therapies, curricula, textbooks, and a host of other education-related services and products. Arizona's ESA law outlines broad categories of eligible expenses — such as textbooks or tutoring — while the state department of education maintains a sort of "whitelist" of approved services and parents can petition to have specific products or services approved. The department has granted parental requests to whitelist learning tools such as Rosetta Stone language software and educational therapies such as equine therapy.

In addition to being able to direct ESA funds to multiple providers and products, parents can save unused funds from year to year and roll the funds into a college savings account. These two features of ESAs — the ability of parents to completely customize their child's education and save for future educational expenses — make them distinct from and improvements upon traditional school vouchers. Parents have the ability to maximize the value their children get from their education services, and, because they control how and when the money is spent, they have a greater incentive to control costs, too.

## VALUE AND EFFICIENCY

In practice, therefore, ESAs work very much like Friedman's "partial vouchers," seeking to harness the way people naturally make spending decisions to create a competitive education marketplace.

In their classic work, *Free to Choose*, Milton and Rose Friedman described four basic ways of spending money. People can either spend their own money or someone else's money, and they can either spend it on themselves or on someone else. The Friedmans argued that people generally have a stronger incentive to economize when spending their own money than when spending someone else's money. Likewise, people generally have a stronger incentive to maximize value when spending money on themselves than when spending on someone else.

The lack of incentive to reduce costs or maximize value is particularly acute when the spender does not know whose money he is spending or on whom he is spending it. For instance, a person is more likely to purchase a lavish dinner with a corporate expense account than when a close friend is paying. Likewise, someone is less likely to maximize value when buying a gift for the

office holiday gift exchange than when buying a gift for a significant other. In the latter scenario, the spender's knowledge of what would provide the greatest value is also considerably higher when he knows the recipient well.

Public-school officials, like all government bureaucrats, primarily engage in the worst kind of spending: They spend other people's money on children who are not their own. As competent and well-meaning as they may be, their incentives to economize and maximize value are simply not as strong as those of parents spending their own money on their own children. As the Friedmans explained in *Free to Choose*, "Only human kindness, not the much stronger and more dependable spur of self-interest, assures that [the bureaucrats] will spend the money in the way most beneficial to the recipients. Hence the wastefulness and ineffectiveness of the spending." It is no wonder then that inflation-adjusted public-school spending per pupil has almost tripled in the last half-century while test scores on the SATs and the National Assessment of Educational Progress have remained flat.

If traditional public-school systems work by spending someone else's money on someone else's children, taxpayer-funded vouchers allow parents to spend taxpayer money on their own children. Parents have a strong incentive to maximize the educational value that their children receive from the voucher, but since a traditional voucher must be spent in a lump sum, there is no incentive to economize below the value of the voucher.

Though Education Savings Accounts are still taxpayer funded, the way they are structured makes for a dynamic closer to the one involved in spending your own money on your own children: Parents still insist on the best quality education but have more incentive to find a bargain. ESAs are not the equivalent of cash because the funds are restricted to approved categories of educational expenses, but they do provide families with much greater flexibility in how to spend (or save) the funds than vouchers do. As a result, parents have the ability and incentive to economize in a manner that more closely resembles their spending of their own money — with both economy and value in mind — which in turn fosters the development of a real education market.

It appears that such a market may be beginning to take shape in Arizona. Early analyses of the Arizona program indicate that parents are using the money to purchase a wide variety of educational services and products. In 2013, the Friedman Foundation for Educational Choice examined how families are using their ESA funds, using restricted data from the Arizona Department of Education. The analysis found that families chose a wide variety of private schools for their children, including Montessori schools, parochial schools (Protestant, Catholic, and Jewish), single-sex schools, Waldorf academies, and schools that cater to children with autism. Sixty-six percent of families used their ESAs solely to pay tuition at a chosen private school of choice, in a manner similar to a school voucher.

Notably, 34% of participants used their ESAs to purchase multiple educational products and services, including curricula, textbooks, private tutoring, therapy, and online educational options. Some families used these products and services to supplement their children's private-school education, while others used them to completely tailor their children's education outside of any traditional school, public or private. In addition, 26% of ESA funds were unspent through the

first quarter of 2013, suggesting that families were saving a portion of their funds in anticipation of future education-related expenses.

## UNBUNDLING EDUCATION

When families can direct their educational funds to multiple providers in this way, those providers can specialize in different educational services that parents and students can use to tailor education to their unique learning needs and interests. This "unbundling" of educational services can allow for greater innovation and diversity, and hence greater value to students and their families.

Some states are already moving toward à la carte education. For example, Louisiana's Course Choice program provides state aid to K-12 students to cover the cost of courses from colleges, public high schools, virtual schools, and private online providers. It enables students to access Advanced Placement and career and technical education courses, allowing them to earn high-school and college credit and industry-based certifications. As *Politico* noted when the program was announced in 2013, the options available through Course Choice are impressive in their diversity: "[Students] might, for instance, take algebra from a math tutoring firm, ACT prep from Princeton Review, pipefitting from a construction trade association, French from an online public school...or all of the above." Louisiana's Course Choice program is limited to students attending a school rated "C" or lower on the state's accountability system and includes a much narrower array of educational services and products than ESAs. Nevertheless, it shows the potential of unbundling course content.

A similar unbundling is occurring in the realm of higher education. Massive Open Online Courses (MOOCs) that provide college courses without the full campus experience are gaining popularity, and are even being offered by the likes of Harvard and MIT. (MOOCs are especially relevant for school choice because some experts are speculating that their biggest impact could actually be at the secondary level.) Software-development training programs are another example of the type of skills-based training that is available outside of the traditional college experience. The Chicago-based Code Academy, the San Francisco-based Dev Bootcamp, and the New York-based Hacker School provide project-oriented training for various levels of programming experience. The Hacker School, for instance, is free to attend, aside from residency and related living expenses. Its goal is to place students in software companies after a three-month training course.

Universal school choice that provides access to quality educational options, as Paul Hill of the University of Washington observes, will "depend on the supply-side, that is, on the success of arrangements that promote the creation of a wide variety of school options, expose all schools to performance pressures through competition, and permit constant replacement of weak schools by promising new ones." The unbundling of services and products encourages a supply-side response that puts pressure on all facets of the traditional education system to be far more responsive to student needs. That pressure could radically alter how education is provided in the long run.

More freedom will bring new options, as families are empowered to tailor education to their children's individual needs. The framers of Arizona's ESA, for example, never imagined that families would use ESA funds to purchase therapeutic horseback riding lessons to help children with cerebral palsy build their motor skills. As more states implement ESA programs, education entrepreneurs are likely to come up with more innovative options. Someday, instead of centrally managed schools, students may attend "education malls" in which multiple providers specializing in different subjects compete to educate students. Students could select different providers for different subjects based on their learning needs and preferences.

The increased educational freedom could benefit teachers as well as students. In August 2013, the *Wall Street Journal* profiled Kim Ki-hoon, a South Korean "rock-star teacher" who earns \$4 million a year. He offers online classes in English to about 150,000 students each year at a rate of \$4 an hour. He spends most of his week "responding to students' online requests for help, developing lesson plans and writing accompanying textbooks and workbooks." ESAs would allow education entrepreneurs like Mr. Kim, who offer superior services at lower costs, to reap substantial financial benefits. Greater educational freedom aligns the interests of teachers and students to the benefit of all.

## **ADMINISTRATIVE CHALLENGES**

As promising as these ESA programs seem to be, they present novel implementation challenges. After Governor Jan Brewer signed the Empowerment Scholarship Accounts into law in 2011, the Arizona Department of Education had to answer difficult questions about how to run the program: How would it determine which products and services would qualify for ESA funds? Was the department responsible for ensuring the quality of qualifying products and services? How would it prevent parents from using the ESA debit cards on non-qualifying purchases?

Navigating these issues was a complex and difficult process. Over time, the department worked through these issues and used the experience to develop an impressive handbook detailing how the ESA works, the history of the program, student eligibility, parents' rights and responsibilities, education providers' responsibilities, qualifying purchases, and reporting requirements, among other details. The handbook will be of particular interest to policymakers considering ESAs in other states.

While the program seems to be working for many of the participating families, there are some areas of implementation where the department is in need of improvement. Enrollment in Arizona's ESA program nearly doubled from 692 students last year to about 1,300 this year, but nearly half of the 2,300 applicants were rejected, indicating either that the state needs to re-evaluate its eligibility criteria or that the department was inappropriately rejecting qualified applicants. The department blamed uninformed families, but a prominent non-profit that helped families apply says that's "insulting" and "misleading." The Hispanic Council for Reform and Educational Options (HCREO) claimed that, even after they had screened applicants to ensure eligibility, the department rejected three-quarters of their roughly 600 applicants. HCREO also faulted the department for lacking Spanish-language translators, failing to return phone calls to parents, and scheduling ESA workshops during business hours when most low-income parents had to be at work.

HCREO recommended that the department make three changes to improve the application process: Create an online application, employ flex hours so that staff can be available outside of regular business hours, and ensure that staff members return phone calls. To its credit, the department's website now allows applications via email. (Previously, applications had to be mailed, hand-delivered, or faxed — but the department's fax machines were out of order during the final week of the 2014-15 application period, which may have prevented some families from applying in time.) Whether the department will implement the other suggestions remains to be seen.

Crucially, these implementation challenges occurred under an administration that was vocally supportive of educational choice and dedicated to providing good customer service. When the political winds shift, the department's administrators may be less supportive of or even hostile to educational choice, as is the case in many state education agencies around the country. Bureaucrats who view the ESAs and other choice programs as inimical to their core mission may even work to undermine the programs.

Florida was the second state to create an ESA program. Their ESA law, called Personal Learning Scholarship Accounts, manages to avoid subjecting the program to bureaucratic inertia or political fortune. While publicly funded, the PLSAs are privately managed by the same non-profit scholarship organizations that participate in the state's scholarship tax-credit program. The PLSA program was created in May 2014, and within six months of being signed into law, the state's largest scholarship organization, Step Up For Students, had already approved ESA scholarships for more than 1,200 students.

It's too soon to draw any firm conclusions, but there are several reasons to believe that Florida's model of privately managed ESAs holds advantages over Arizona's government-managed model. First, the non-profit scholarship organizations are less likely to be captured by opponents than is a government agency. The non-profits are dedicated to the scholarships, and the idea of school choice is built into their mission. Second, awarding scholarships is the primary mission of a scholarship organization but only an ancillary function of a state education agency — which means that not only will they be more dedicated to the concept but they can generate and retain best practices more easily. Third, scholarship organizations have the ability and incentives to be more flexible in their operation than government agencies, and therefore more responsive to the needs of families. The Arizona education department did not offer workshops for parents outside of regular business hours because employees were not paid for those hours. Non-profits can more easily implement policies like flextime.

When crafting ESA laws, policymakers nationwide should examine the experiences of Arizona and Florida, as well as programs that allow individuals to contribute to their own accounts, such as Coverdell ESAs and health savings accounts. Coverdell ESAs — formerly known as Education IRAs — are federally authorized tax-advantaged investment accounts that families can use to save for college or to pay for qualified K-12 education expenses. However, the Coverdell contribution limit is only \$2,000 per year, less than a sixth of the national average cost per pupil at public schools. States might combine this model with the Arizona or Florida ESA models by allowing parents who opt not to enroll their child in the public school to receive tax credits against their state income-tax liability in return for contributions to their own ESAs. The

tax credits could be capped at a certain percentage of what the state would have spent to educate that child to ensure savings to the state.

## **THE BLAINE AMENDMENTS**

Before they can tackle any administrative challenges, policymakers in some states must address a constitutional challenge to the taxpayer funding of private education. While the United States Supreme Court has ruled that publicly funded school vouchers are constitutional under the First Amendment's Establishment Clause, most state constitutions contain a version of the so-called "Blaine Amendment," which bars state aid to parochial schools. In addition, most state constitutions also contain an older "compelled support" clause, which forbids compelling taxpayers to support religious institutions through public funding.

Named for the late-19th-century senator James Blaine of Maine, the Blaine Amendments were intended to prevent Catholics from acquiring taxpayer support for their parochial schools. In those days, most public schools, known as "common schools," operated as nondenominational Protestant schools. "The common school and the vision of American life that it embodied came to be vested with a religious seriousness and exaltation, becoming the core institution of American society," writes education historian Charles Glenn. "In close alliance with but never subordinate to the Protestant churches, the common public school occupied a 'sacred space' where its mission was beyond debate and where to question it was a kind of blasphemy."

Catholics established their own schools, and sought public funding of the sort the Protestant common schools enjoyed. Supporters of the common-school movement, however, perceived a threat to its mission in such proposals. Blaine ultimately failed in his effort to amend the U.S. Constitution to bar public aid to "sectarian" schools, but most states adopted a version of his proposed amendment, and more than two-thirds of the 50 states have a Blaine amendment on the books today.

In the 2002 case *Zelman v. Simmons-Harris*, the United States Supreme Court upheld the constitutionality of a school-voucher law in Cleveland, Ohio, using a five-part test. First, the majority found that the law served a secular purpose by "providing educational assistance to poor children." Second, the state allocated the voucher funds to the parents, not the religious schools. Third, a "broad class" of students was eligible to receive the vouchers. Fourth, the law was neutral with respect to religion because parents could opt to use the vouchers at religious or secular schools. And fifth, there was a significant number of secular options from which parents could choose.

Some state supreme courts have interpreted their Blaine Amendments in a manner consistent with the U.S. Supreme Court's First Amendment jurisprudence. For example, in 2013 the Indiana Supreme Court unanimously upheld a voucher law because the law served a secular purpose and the funds were allocated to parents. Other state supreme courts, however, have interpreted their Blaine Amendments to be more restrictive. In the 2009 case *Cain v. Horne*, the Arizona Supreme Court struck down a voucher law for children with special needs and foster children, finding that it unconstitutionally entailed the "appropriation of public money...in aid of...sectarian school[s]."

Unlike vouchers, scholarship tax-credit laws have a perfect record of constitutionality thus far. The Arizona Supreme Court had previously upheld a scholarship tax-credit law, which granted dollar-for-dollar tax credits to taxpayers in return for contributions to non-profit scholarship organizations that help families send their children to the schools of their choice. The court ruled that tax-credit funds did not constitute "public money" because "no money ever enters the state's control as a result of this tax credit." The U.S. Supreme Court later applied similar reasoning in the 2011 case *ACSTO v. Winn*, rejecting the standing of petitioners to challenge Arizona's scholarship tax-credit law because the funds did not become public money since they had not "come into the tax collector's hands."

Where ESAs entail the allocation of public funds, they may not withstand scrutiny in states where courts have adopted very restrictive interpretations of the Blaine amendment. Nevertheless, the example of Arizona is encouraging on this point for advocates of ESAs. Despite having previously struck down vouchers, in March 2014 the Arizona Supreme Court declined to review an appeals-court decision upholding the state's ESA law. The court distinguished the ESAs from vouchers because the latter "set aside state money to allow students to attend private schools" whereas under the ESA law, "the state deposits funds into an account from which parents may draw to purchase a wide range of services" and "none of the ESA funds are pre-ordained for a particular destination."

It is an open question, however, whether other state supreme courts that have adopted more restrictive interpretations of their Blaine Amendments will find the Arizona court's distinction compelling. Currently, the Florida Education Association is challenging the constitutionality of the state's nascent ESA law under the state constitution's Blaine Amendment and other provisions.

Policymakers could avoid the constitutional uncertainty altogether by funding the ESAs privately, through tax credits, rather than through government allocation. This approach would have the added benefit of avoiding the compulsion inherent in all taxpayer-funded programs. As Milton and Rose Friedman wrote in *Free to Choose*, "Voluntary gifts aside, you can spend someone else's money only by taking it away as government does. The use of force is...a bad means that tends to corrupt the good ends." Conflicts in public education over issues such as political agendas, teaching evolution, and sex education spark social conflict in part because citizens are forced to pay for the promulgation of ideas with which they disagree. Shifting to a model of education funding that allows taxpayers to choose what forms of education they will financially support with their own money would likely reduce social conflict over these programs.

Two existing laws already embody some elements of the tax-credit-funded ESA model, and they can help point a way forward. As noted, Florida's ESA law is privately administered by the same non-profit scholarship organizations whose donors receive dollar-for-dollar tax credits for their contributions to scholarships. Such an approach leverages private philanthropy to strengthen school choice. Likewise, New Hampshire's scholarship tax-credit law includes an ESA-style provision that allows homeschoolers to spend scholarship funds on a variety of educational products and services similar to those permitted by the Arizona and Florida ESA laws.



## REDUCING REGULATORY THREATS

In addition to placing them on firmer constitutional ground, funding ESAs through tax credits could also reduce the threat of harmful regulations.

In a generally well-meaning effort to impose "accountability," some policymakers have attempted to regulate school-choice programs as they regulate district schools, including by mandating state tests. However, rules designed to regulate a monopoly like a public-school system are not appropriate for a market. Beyond basic health and safety regulations, top-down accountability measures are generally unnecessary at best and harmful at worst. Centralized standards, especially in the form of state testing mandates, induce conformity that can undermine the innovation and diversity that give educational choice its value. Whereas government-run schools are primarily accountable to elected school boards and unelected state education bureaucrats, private education providers are accountable directly to parents, and the same market forces that place competitive pressure on other kinds of businesses operate on these education providers as well.

Research indicates that privately funded school-choice programs are less likely to be overregulated than publicly funded programs. A 2010 study by Andrew Coulson of the Cato Institute found that direct government expenditures, "but not tax credits, impose a substantial and statistically significant additional regulatory burden on participating private schools." In May 2014, a study by Andrew Catt of the Friedman Foundation found that scholarship tax-credit laws generally imposed very few additional regulations on schools when first enacted and over time.

At least two reasons explain why scholarship tax-credit programs are less likely to be overregulated. First, as with tax deductions and tax exemptions, policymakers are less likely to attach strings to tax credits than to public expenditures, since the money never actually comes into the state treasury. Second, scholarship tax-credit laws enable supporters of school choice to organize so that they can more effectively fight harmful regulations: Scholarship organizations can help both scholarship recipients and the donors mobilize against potentially harmful legislation. Educational-choice programs are therefore more likely to be politically sustainable in the long run if they are privately managed and privately funded.

These choice programs are designed specifically to free schools from stifling regulations, in an effort to yield better education for children. And educational-choice programs consistently produce higher levels of parental satisfaction than assigned district schools. For instance, the Friedman Foundation surveyed Arizona families with ESAs to measure the levels of parental satisfaction. (All of the survey respondents had children with special needs.) The respondents unanimously reported being more satisfied with the education they purchased for their child with the ESA funds than with their child's prior public school: 71% of respondents reported being "very satisfied" with their ESAs, 19% were "satisfied," and 10% reported being "somewhat satisfied." Not a single parent reported being dissatisfied, or even having "neutral" feelings about the program.

Several random-assignment studies show that educational-choice programs also produce improved academic performance and higher rates of high-school graduation and college

matriculation, all useful proxies for measuring the success of these programs. Most recently, multiple analyses of the New York City Choice Scholarships Foundation program found that students who received scholarships as a result of a lottery had math scores that were five percentage points higher on average than the control group. Black scholarship recipients were 8.7% more likely to attend college within three years of graduation. In 2010, the U.S. Department of Education found that students who were offered a voucher in the Washington, D.C., voucher lottery graduated high school at a rate 12 percentage points higher than students in the control group. The graduation rate among students who actually used the voucher was 21 percentage points higher than that of the control group.

The best way to enhance accountability and performance is to empower parents to choose the education that works best for their kids.

### **VISIONARY BUT PRACTICAL**

Most school-choice programs offer significant but not revolutionary changes to the traditional educational model. But true educational choice, and the educational market it could help foster, promise to radically improve education for many children. As Milton Friedman observed, "not all 'schooling' is 'education,' and not all 'education' is 'schooling.'" Charter schools and voucher programs still conflate the two, but education savings accounts embody a more expansive understanding of education.

ESAs offer several key advantages over traditional school-choice programs. Because families can spend ESA funds at multiple providers and can save unspent funds for later, ESAs incentivize families to economize and maximize the value of each dollar spent, in a manner similar to the way they would spend their own money. ESAs also create incentives for education providers to unbundle services and products to better meet students' individual learning needs.

For our nation's education system to incorporate this key insight, states must rethink at the most basic level how to fund education — a process that will not be without challenges. Like other educational-choice policies, ESAs face administrative challenges, constitutional obstacles, and regulatory threats. And while not conclusive, the relative experiences of Arizona and Florida may suggest that private administration of an ESA program will be more efficient and effective than government management. While government-funded voucher laws have had a mixed record in state courts, educational-choice laws that are privately funded through tax credits have a perfect constitutional record thus far. And empirical research suggests that educational-choice laws are less likely to be over-regulated when they are privately funded.

As Friedman said of school choice decades ago, this proposal is visionary but not impractical. Two states have already adopted ESA laws and more are likely to follow in the coming years. These laws hold great potential to expand educational opportunity and remake the entire education system in ways that better and more efficiently meet the needs of children.

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