Toward a Free Market in Education: School Vouchers or Tax Credits?

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More and more Americans are coming to recognize the superiority of private schools over government-run or "public" schools. Accordingly, many Americans are looking for ways to transform our government-laden education system into a thriving free market. As the laws of economics dictate, and as the better economists have demonstrated, under a free market the quality of education would soar, the range of options would expand, competition would abound, and prices would plummet. The question is: How do we get there from here?

Andrew Bernstein offered one possibility in "The Educational Bonanza in Privatizing Government Schools" (*TOS*, Winter 2010-11): Sell government schools to the highest bidders, who would take them over following a transitional period to "enable government-dependent families to adjust to the free market." This approach has the virtues of simplicity and speed, but also the complication of requiring widespread recognition of the propriety of a fully private educational system—a recognition that may not exist in America for quite some time.

Another possibility is to begin the transition from the status quo to a fully free market by providing Americans with a choice in how and where to apply their education dollars. This possibility has the virtue of being feasible today, as there is already substantial support for it in the burgeoning "school choice" movement. The difficulty with this approach lies in developing and implementing a school choice program that moves American education toward a free market rather than extends the arm of government further into education.

Within the school choice movement, there are essentially two schools of thought regarding the best mechanism for enabling parents to choose where to spend their education dollars. One camp advocates government-issued, tax-funded *school vouchers*; the other advocates *education tax credits*. The vouchers camp is far more popular and is already making political headway, while the tax credit camp is relatively small and has yet to develop a viable program. This is unfortunate because, as we shall see, the implementation of a school voucher program would be a disaster for American education long term, whereas the implementation of a proper tax credit program would put America squarely on the road to a fully free market in education.

School Vouchers

In a typical school voucher program, a government agency issues to parents (or guardians) education allowances that come from tax revenues. The parents then enroll their child in the school of their choice, using the voucher as partial or full payment toward the yearly tuition. For example, if Jane and John Doe receive a voucher for $5,000 and enroll their child in a school with a tuition of $7,000, they give the school the voucher plus $2,000 out of pocket. The school then presents the voucher to the issuing government agency and redeems the tuition balance of $5,000. Details aside, the essential element of a voucher program is that the government provides parents with vouchers for use at schools other than their child's assigned government-run school, and the schools then redeem the vouchers for tax monies collected by the government.[1]

Milton Friedman first introduced this general idea in 1955 in his essay titled "The Role of Government in Education." In this paper, Friedman endorsed a system of universal, tax-supported education vouchers for elementary and secondary schooling (K–12). Under Friedman's plan,

Government, preferably local governmental units, would give each child, through his parents, a specified sum to be used solely in paying for his general education; the parents would be free to spend this sum at a school of their own choice, provided it met certain minimum standards laid down by the appropriate governmental unit.

Although a voucher program would introduce some degree of "school choice," it would, Friedman acknowledged, involve "the financing of education by the state" and would necessarily entail "the imposition [by the state] of a minimum required level of education."[2] Parents would be able to apply their government-issued vouchers toward tuition at private schools—but only so long as those schools conform to the government's notion of an "appropriate" education.

Far from being a step in the direction of a free market in education, voucher programs extend the coercive arm of the government into private schools. Once the government is footing the bill for private school attendance, what is to stop it from dictating which subjects the schools will teach and how they will teach them? As the Alliance for the Separation of School and State notes, "By creating a flow of money from the state to private schools, vouchers pave a wide road for additional regulations and controls. 'When you reach for the money is when they slip on the handcuffs.'" For instance, most voucher programs enable the government effectively to "dictate the curriculum" by requiring "voucher-redeeming schools to administer standardized tests."[3]

Examples of such regulations and controls can be seen in various pilot programs across America. In the Milwaukee program, for instance, the government places strict limits on eligibility with respect to parental income, regulates participating schools' admissions processes, and prohibits schools from charging tuition above the voucher amount.[4] And in Florida, private schools participating in the state voucher program "must take a nationally recognized standardized test and their results must be reported to the state."[5] Such government intervention in private schools is rampant in voucher programs. In his study of school choice programs in fifteen states and Washington, D.C., Andrew J.

Coulson writes, “Voucher programs are associated with large and highly statistically significant increases in the regulatory burden imposed on private schools (compared to schools not participating in choice programs).”6

Further evidence of this problem can be seen in Sweden, which has implemented a nationwide school voucher program. Instituted in 1991, this program places all schools under the control of a National Agency for Education (NAE). Following Friedman’s model, the government gives parents vouchers; the parents hand the vouchers to the schools of their choice; and the schools redeem the vouchers for tax dollars from the government. All parents are eligible to use their vouchers to choose an alternative to the government-run schools for their child—but only if those schools are NAE-approved. To be approved, the “private” schools, called “independents,” must conform to myriad regulations, including relinquishing the rights to charge additional fees and to choose which students they admit.7

The Fraser Institute sums up the Swedish system:

[Sweden’s] public vouchers have made independent schools dependent on public funding, and consequently, have given elected officials the power to make independent schools submit to public controls. The problem is not that the regulations imposed so far on admission of students and fees have impinged on the educational quality of many schools. Rather, the danger is that these central controls, which were minimal at first in Sweden, continue to multiply so that eventually independent schools are absorbed into the centrally controlled system.8

As a result, according to one observer, Sweden’s “independent” schools have become “essentially what we call ‘charter schools’ in the United States, rather than true private schools.”9

Voucher programs and their accompanying controls and regulations represent a clear threat to the private nature of the private schools that participate. But what of those private schools that would opt out of a voucher program? The Alliance for the Separation of School and State notes:

Other than expensive prep schools, private and religious schools that refuse to accept the voucher will lose a significant number of their students to voucher-redeeming schools. Many will face the choice of accepting the voucher—and its controls—or going out of business.

The net result . . . is that if vouchers become commonplace, private and religious schools will become more and more like public schools. In effect, vouchers and other plans for continuing to use tax revenue for schools will kill the goose that is laying the golden eggs of private education.10

Because they enable parents to choose the schools to which they send their children—and thus establish some measure of competition among schools—school vouchers might, at first glance, appear to be a step in the direction of a free market. But, on examination, it becomes clear that vouchers necessarily extend government control to private schools. The principle here is simple: *Whoever pays the bill ultimately has the power to set the terms*. To the extent that the government pays tuition money to private schools, the government gains control of private schools. And if the government gets a foot in the door, it will eventually walk in all the way.

At present, private schools in America have a relatively high degree of autonomy. They are essentially free to determine their own curriculums, to accept or reject students according to their own standards, to charge whatever tuition and fees they see fit, and to innovate according to their own judgment. But under a voucher program, these freedoms would be taken away as the bureaucratic handcuffs were slipped on the wrists of private schools, which over time would cease to be private. This is not hyperbole; it is a reality that can be seen wherever voucher programs have been instituted—and even where they have been merely proposed. As a final example, consider the proposed "school choice" program in New Jersey.

The ultimate goal of New Jersey's Opportunity Scholarship Act (which, as of this writing, is working its way through the New Jersey legislature),[11] is, in the words of Governor Chris Christie, to establish a "voucher system that lets any child in New Jersey go to any school, public or private."[12] The Act, says Christie, "is the first step . . . which will lead to school vouchers across the state of New Jersey so the choice is available to every parent and every child."[13]

The New Jersey program, unlike most voucher programs, includes a feature that attempts to get around the problem inherent in government payments to private schools. Whereas a typical voucher program is funded by all taxpayers in the locale in which it is instituted, the New Jersey program would be funded by participating corporations, which would, in turn, receive reductions in their tax liability to the state. Because the corporate contributions never reach the state's coffers, this feature might appear to give private schools participating in the Act insulation from the government qua payer. The problem, however, is that these corporate contributions would be disbursed to students as vouchers by a state-approved intermediary called the "Opportunity Scholarship Board" comprising government appointments.[14] Because the state would ultimately determine how and to whom the vouchers are distributed, New Jersey's proposed program is essentially no different from Sweden's program.

One clue as to how disastrous the program would be is that it has significant support from many New Jersey liberals and Democrats, despite strong opposition from the state teachers' union.[15] Cosponsored by a prominent Democrat, the Act was unanimously approved in 2010 by a Democrat-controlled committee in the Democrat-controlled New Jersey Senate,[16] and more recently advanced in another two legislative committees with bipartisan support.[17] What would motivate these Democrats to stand in opposition to the state teachers' union, one of its core constituencies and greatest sources of political contributions?

Although Democratic cosponsor Senator Raymond Lesniak hails the proposed program as an "opportunity for a quality education that the children from poor families are not getting,"18 the likely motivation for most liberals supporting the program is that it could be employed to bring the largely unregulated private schools under government purview.19 For instance, the left-leaning *Star-Ledger*, New Jersey's largest newspaper and a major supporter of the Opportunity Scholarship Act, approved of aspects of the bill but lamented that it would not go far enough in imposing controls on the schools receiving the voucher payments. The editors write:

[T]he bill fails to hold private schools accountable. It requires them to test voucher students with the same tests given in public schools, and that's a start. But it has no mechanism to exclude private schools that are failing these kids.20

What do "accountability" and "failing these kids" mean here? They mean accountability to the government and failing to educate kids according to government standards. And observe that the *Star-Ledger* wants private schools participating in the program not only to administer the government-approved standardized tests, but also to be kicked out of the program if their students do poorly on these tests. The logic of the situation is simple: If the government is handing tuition checks to schools, the government can require that those schools meet the government's standards—and the left will demand that it does.

As noted by the Alliance for the Separation of School and State, any standardized testing requirement provides a back-door means of controlling private school curricula. The "accountability" that the *Star-Ledger* (and others) demands would grant bureaucrats ever-widening latitude in dictating to private schools not only what private schools must teach, but also who they must accept, whether their students must "volunteer" for community service, whether they are sufficiently "green," what tuition they may charge, and so on. Schools that fail to conform to the government's criteria would lose students and funding, while those that comply would gain students and funding. This is what New Jersey's private schools would ultimately have in store if the Opportunity Scholarship Act becomes law.

Like the aforementioned voucher plans in other U.S. states and Sweden, the New Jersey plan ostensibly seeks to diminish the government's stranglehold on education. And, like those plans, the New Jersey plan, if implemented, will eventually extend that stranglehold to private education. When the government is paying for private education—even *indirectly*, as through the Opportunity Scholarship Act's state-approved intermediary—government intervention follows on the grounds that it is necessary to ensure that taxpayer funds are delivered to schools that meet government standards.

Such is the problem inherent in school voucher programs. To avoid this problem, we need a "school choice" program in which the government plays *no part* in paying for private school education.

Education Tax Credits

Whereas under a voucher program, tuition money goes from taxpayers to the government for disbursal to government-approved schools, under a properly structured tax credit program, the tuition money never goes to the government. Rather, that money is retained by taxpayers who opt into the program for use on education in the private market.

A tax credit is simply a reduction in one's tax liability to offset a particular expenditure, in this case for education. For example, if Jane and John Doe receive a tax credit of $2,000 for their child each year, they could send their child to a private school costing $5,000 per year, pay the school $5,000, and receive a full $2,000 reduction in that year's tax liability. (This is different from a tax *deduction*, which only lowers the taxpayer's taxable income.) Because the government never gets its hands on the tuition dollars in question, it cannot claim any right or responsibility to dictate where or how that money is to be spent.[21] The government is simply out of the loop.

Let us briefly consider the essential elements of a viable education tax-credit program and then elaborate how it would work in practice.

Under such a program, all taxpayers—whether parents, guardians, people without children, or corporations—would be eligible to claim tax credits for the purpose of funding the education of one or more children in K–12 schools in the corresponding year.

The amount of money a given taxpayer could retain as a credit and put toward a given child's education would be determined by reference to two easily calculable monetary figures, the Education Tax Liability and the Average Attendance Cost.

The Education Tax Liability (ETL) is the amount of money the government would otherwise take from the taxpayer for use in the government-run schools. This amount includes income taxes, property taxes, and any other feasibly calculable taxes that apply.[22] The Average Attendance Cost (AAC) is simply the amount of money that would be spent on a student attending a government-run school in his assigned school district that year.[23]

The program would be optional, and those who choose to forgo the program would simply continue paying taxes to fund the government-run schools. Those who opt to participate in the program would be free to retain as much of their ETL as they choose and apply it to the tuition and other educational expenses of any child in any K–12 school to which the child is accepted.[24] The limit on how much of his ETL a taxpayer could apply to a given child's education would be that child's AAC.

A taxpayer could contribute funds from his tax credit to more than one child, and a child could receive tax-credit contributions from more than one source, so long as the respective parties did not exceed their ETLs and AACs.

Finally, a child's parents (or guardians) would be free to apply funds from tax-credit contributions—whether their own contributions or contributions from other taxpayers—toward *any* expense the parents regard as relevant to the child's education. As would be the case in a fully free market for education, the government would have absolutely no say in what constitutes legitimate education expenses and no ability to audit parents to determine whether they were using credits for expenses the government deemed acceptable. The government's role would be merely to calculate and post ETLs and AACs and to continue disbursing to government-run schools whatever education-marked tax money it collects.

To see how this tax-credit program would work, let us consider a few hypothetical but typical scenarios, all of which assume for the sake of simplicity that the average attendance cost (AAC) is $10,000.

Suppose a mother who has a $9,000 estimated tax liability (ETL) opts for the tax-credit program in order to send her child to a private school and that her son's tuition costs at that school are $12,000. The mother deducts from her taxes that year what she spent on her son's education, up to her $9,000 ETL, and either foots the $3,000 difference or finds other means of financing it.

Observe that although the AAC allows for spending up to $10,000 on a child, this mother's ETL amounts to only $9,000. The reason for limiting her tax credit to her ETL is that taking a credit of an additional $1,000 against her noneducation taxes would amount to forcibly taking $1,000 from other taxpayers and using it to subsidize her son's education. One of the many virtues of this program is that it entails no such "public" subsidization of private education.

Now suppose a different mother has a $12,000 ETL that same year and sends her son to the same school. Even though her ETL would amount to exactly the $12,000 tuition cost of the school, this parent could deduct from her taxes only the $10,000 AAC. Why limit her to the $10,000 AAC if her ETL is greater? If the tax credits applied to her son's private education do not exceed those that would have been spent on his public education, then the government-run school system is shorted only the amount of money that would have been spent on her son had he attended. This feature satisfies the practical requirement that a transitional education program continue to adequately fund the government-run school system in the short term and silences critics who would claim that tax credits necessarily lead to underfunded government-run schools.25

Consider how this would work for lower-income families. Suppose a couple has an ETL of $1,000 and would like to send their daughter to the same private school. If they opt to participate in the tax-credit program, they would have to pay the $11,000 difference. Note first that under the tax-credit program, although the couple must pay $11,000 of the tuition themselves, they are better off than they would be under our current system, in which they would have to pay the full $12,000 tuition *and* send in their ETL of $1,000 with the rest of their taxes—a $2,000 difference. But this tax-credit program would provide further opportunities for relief to such lower-income parents.

Under this program *any* taxpayer would be free to apply *any* amount of his ETL to the education of *any* K–12 student, so long as the combined contributions put toward that student's education do not exceed his AAC. A taxpayer without school-age children of his own could contribute his tax credit to the education of his grandchildren, or the child of a sibling, friend, neighbor, or stranger. For instance, a taxpayer with a $20,000 ETL could fully fund the education of two grandchildren at $10,000 each, or partially fund the education of four grandchildren at $5,000 each, so long as the total contributions made to any one child's education by all contributing parties do not exceed the child's $10,000 AAC.

The low-income couple mentioned above might well find several relatives and friends willing to put their tax credits toward the education of the couple's daughter. If the couple were to find nine willing relatives and friends who could each contribute $1,000 on average, their daughter's private school tuition would be paid up to the $10,000 AAC, leaving the couple to produce or finance only an additional $2,000.

(Note that, regardless of how the student's tuition is paid and who pays it, only the AAC of one student fails to reach the government-run system.)

Further, because students could receive financing from complete strangers under this program, private charitable organizations could establish scholarship funds to which any taxpayer—including corporations—could contribute up to the amount of his or its ETL. Government would have no role in the disbursement of such scholarships. Rather, these organizations could disburse ETL funds to students on whatever basis they choose so long as donors remain within their ETLs and so long as recipients receive no more than their AACs.

For instance, a scholarship fund that receives tax-credit donations totaling $3 million could fund three hundred students at $10,000 each—according to its chosen criteria. It could aid children from low-income families, children demonstrating academic promise, children of active servicemen, or any other children it saw fit to aid. Contributions collected in a given year but not distributed to private school attendees for that year would be turned over to the relevant government agencies to fund the government-run schools, thereby maintaining the AAC-based equilibrium.

In addition to the above uses of the tax credits, parents and other taxpayers could apply the credits to the repayment of education loans taken to spread tuition payments over time. The same rules would apply here as elsewhere: The tax credit—applied in this case to payments to the lending entity—could not exceed the taxpayer's ETL, and the total tax credits contributed to the student's education each year could not exceed his AAC for that year.26 Parents could also claim tax credits to homeschool their children, and other taxpayers could contribute to such homeschooling.27 All the while, fully funded government-run schools would remain an option for all children.28

The role of government under this proposal would be severely limited. The government would have to calculate and report to each taxpayer his ETL and the child's respective local AAC so that taxpayers and accountants could plan for the year and file accordingly. (The private sector could calculate these independently as well, so as to keep the government honest.) The government would also have to keep track of tax credits applied to a given student, which could be handled in the process of tax filing. Importantly, however, the government would not distribute education dollars to private schools because the government would never take possession of that money in the first place. The participating taxpayer would hand his education dollars directly to the educators he chose to fund and merely note on his tax filing the amount of tax credit used and to which student (or students) it was applied.

A tax-credit program such as this would not only give parents control over their children's education and increase education options for all American children—it would put America on a road toward a fully free market in education. With an influx of new customers and a lack of regulation, the private sector in education would expand rapidly, causing the public sector to shrink while remaining proportionally funded. In time, there would simply be no demand for government-run schools, education taxes could be repealed, and the transition would be complete.

Conclusion

School choice programs are rapidly gaining popularity and political viability, and free market advocates can and should cash in on this opportunity. The "school choice" movement laudably seeks to wrest control of children's education from the state and turn it over to those to whom it logically, morally, and rightfully belongs—the parents. However, it is crucial that this movement carefully choose the reforms it advocates. In its enthusiasm for change, the choice movement must not ignore the wide-range and long-range implications of the change it advocates.

Advocates of "school choice" often view vouchers and tax credits as more or less synonymous, differing only in technical details. As we have seen, however, there is a fundamental difference between the two financing methods—a difference that has profound significance: The first is a statist "Trojan Horse" set to destroy the private nature of private schools; the second is a means to more parental choice and less government interference in education. Vouchers ultimately leave parents with a "choice" of state-financed and thus state-controlled schools. Tax credits, properly implemented, provide parents with a means of escaping the government's clutches by removing the state as a monetary intermediary, thereby establishing a wall that unites private funding and private schools on one side, and keeps the state at bay on the other. This separation of school and state should be the goal of the parental school choice movement. The implementation of an education tax-credit program such as the one proposed here would set us well on our way toward this goal.