CONTROVERSY

Giving Credit Where It's Due

Why Tax Credits Are Better Than Vouchers

ANDREW J. COULSON

In his article "Why Conservatives and Libertarians Should Support School Vouchers," Joseph Bast argues that these groups should do so because vouchers are consistent with their political views. The wisdom of that recommendation is questionable, for two reasons: first, because this same argument would encourage Democrats and some centrists automatically to reject vouchers (and every other market-based reform); and, second, because our children's futures are too important to be decided by our political orientations.

Bast also voices his disappointment in supporters of education tax credits for their having publicly raised concerns about vouchers. He equates such criticism with "taking away from people their freedom to choose" and with a willingness "to substitute one's own judgments for the informed decisions of people." In making those equations, Bast errs. An honest and open public-policy debate neither disfranchises the American people nor prevents them from making informed decisions. On the contrary, it is essential to their ability to make such decisions.

Though Bast may have reservations about the public airing of concerns over vouchers, he at least will be pleased to know that, for reasons to be given, this critic

Andrew J. Coulson is a senior fellow of the Mackinac Center for Public Policy and editor of www.schoolchoices.org.

The Independent Review, v.VII, n.2, Fall 2002, ISSN 1086-1653, Copyright © 2002, pp. 277–287.

favors the expansion of existing voucher programs. Although I recommend the adoption of tax credits over vouchers wherever possible, I do not oppose the passage of voucher legislation in states that knowingly choose that course.

Market Education: Smorgasbord or Ecosystem?

Nearly all pundits and reformers assume that education markets compose a smorgasbord from which we can select or reject policy details according to personal taste or political expediency. This assumption, rarely acknowledged and never defended, is wrong.

Properly functioning education markets much more closely resemble delicate ecosystems in which the alteration or removal of key elements leads to the decline or collapse of the entire system. That conviction, at any rate, is the one I have reached after spending years comparing historical and international school-governance structures from classical Greece to modern Japan (Coulson 1999). The five elements that seem crucial to the longevity and effectiveness of market education are: parental choice, direct financial responsibility for parents, freedom for educators, competition among schools, and the profit motive for schools.

Readers of this journal are no doubt already familiar with the importance of consumer choice in a free and vigorously competitive market. The need for significant competition is indeed one reason why even dedicated proponents of the voucher concept have criticized existing voucher programs. Economist John Merrifield has repeatedly noted (most notably in Merrifield 2001) that existing small-scale voucher programs do not engender enough competition to produce the full benefits associated with a genuinely competitive education marketplace. For this reason, among others, I strongly advocate the expansion of existing voucher programs: any haze of uncertainty that opponents of market education may conjure up around these programs likely would be cleared away by enlarging the number of competing schools.

Because both parental choice and professional freedom for educators are goals that all proponents of market education share, I need not discuss them here. Three down, two to go.

The role of profits, though generally accepted and understood in fields outside of education, unfortunately elicits less enthusiasm when applied to teachers and schools. In the absence of the profit motive, the constant progress in technology, quality, and efficiency that are taken for granted in other sectors of the economy essentially have been absent in education. Whereas the most popular for-profit businesses expand to meet growing demand, nonprofit schools simply expand their waiting lists. The nation's leading nonprofit private schools enroll just a few hundred or perhaps a thousand more students today than they did a century ago, withholding their high-quality services from throngs of children who could benefit greatly from them.

Such withholding is most emphatically not the case in the for-profit education sector, which thrives in the gaps left by state schooling (Vedder and Hall 2002). Because public schools group students rigidly by age and aim lessons at a mythical average child, the brighter and slower students are marginalized. This problem is especially pronounced in Japan, where the curriculum is unusually rigid. The need for both advanced and remedial instruction to compensate for the rigidity of Japanese public schooling was one factor leading to the explosive growth of *juku*, or "after-school schools." A case in point is the popular Kumon chain. Having begun with a single school in 1958, it now enrolls 1.36 million students in Japan and another 1.49 million abroad. Moreover, Kumon is just one school in a vigorously competitive, multi-billion-dollar-a-year market.

On the issue of profit making, I suspect that Bast and I agree. Vouchers would not obstruct for-profit schooling unless it was expressly forbidden in the authorizing legislation, either at its inception or by later amendment.

I come, then, to one key disagreement with Bast's position: the presence or absence of direct financial responsibility for parents. In the following section, I explain how vouchers and tax credits differ in this regard, and I spell out some implications of that difference.

Tax Credits or Vouchers? Weighing the Evidence

Under a universal voucher program, all parents would receive voucher checks from state governments to cover most or all of the cost of their children's education.

Under the two-part tax credit system most often proposed as an alternative to vouchers, the majority of parents would pay for their own children's education and receive a nonrefundable credit against their state and local taxes to offset the cost of tuition.[1] That credit is the first part of the plan. Parents satisfying a certain income or family-size criterion would receive scholarships from private organizations, and the individuals and businesses donating funds to these organizations would receive dollar-for-dollar credits against their own tax burdens. That credit is the second part of the plan.

Although private scholarship programs are barely a decade old and few states currently have tax credit laws to encourage them, 108 such programs are already in operation, serving more than one hundred thousand students nationwide. While this number is a tiny fraction of the total student population, it is a larger number than is currently served by government voucher programs.

Under the dual tax credit system just described, parents who do not receive scholarships pay the entire cost of their own children's education, whereas those who do receive scholarships generally are expected to make a small copayment or to offer in-kind services in lieu of a copayment. The common expectation under a universal voucher

1. Nonrefundable credits can reduce the total tax burden only for families who owe state and local taxes. If a family owes less in taxes than the value of the credit, the tax burden is reduced to zero, but the family does not receive a payment for the balance. This feature distinguishes nonrefundable tax credits from vouchers. Refundable tax credits, which can result in payouts to taxpayers from government coffers, are essentially the same as vouchers.

program would be for most families simply to sign over the government voucher check to their school of choice as full payment. Clearly, then, direct financial responsibility for parents is greater in a tax credit system than in a voucher system. So what?

Advantages of Tax Credits

The importance of direct financial responsibility reflects, first, the advantages of having the parents pay tuition and, second, the disadvantages of having a third party (in particular, the government) pay.

Parents historically have been able to retain control of their children's education for sustained periods only by assuming the cost. Wherever governments have subsidized education at the elementary and secondary level, parental choice has been either curtailed or eliminated—for example, in the government boarding schools of Sparta in the fifth century B.C., in Rome when emperors began paying teachers out of government coffers in the first century A.D., and in Baghdad when Nizam Al-Mulk founded the first government-funded *madrasa* in 1066. Likewise in France during and after the revolution, in England and the United States during the late nineteenth century, and, to a lesser but still significant extent, in Holland in the twentieth and twenty-first centuries (Coulson 1999).

The case of Holland is particularly illustrative. Seventy percent of Dutch schools are "private" and chosen by parents, but the government pays for them according to their enrollment figures—the system is substantially similar to a universal voucher. Under this program, the state has come to define teacher accreditation requirements, fix salary scales, curtail the firing of teachers, set curriculum standards, say how much can be spent, make it illegal to charge consumers for education (with the exception of small facilities fees), and prohibit profit-making (James 1999). Such interventions—which affect curriculum and personnel decisions and forbid the profit motive—have a significant impact on both parental choice and the freedom of educators. He who pays the piper—or perhaps, in our post-Enron world, the accounting firm—calls the tune.

Direct payment by parents leaves schools with only two options if they wish to increase their net income: either they offer improved services (for which parents will pay more) or they lower their costs. When schools are paid by the state, however, they have another option: they simply lobby government officials for larger payments. No improvement in quality or efficiency need be demonstrated. Though public-school performance either stagnated or declined over the past century, spending (in real dollars) has risen by a factor of fourteen since 1929 (Coulson 1999, chap. 6). Moreover, in 1998 the Department of Education's books were so sloppy that they *could not be audited*. No one knows for sure what the department purchased with its $120-billion-dollar budget ("Failing Our Children" 2000).

Bast not only argues that schools would resist the temptation to lobby for larger vouchers, but asserts that many would demand less money. To my knowledge, such behavior would be unprecedented in the history of government-funded elementary and secondary education, and Bast presents no evidence to support his view.

So long as the parents themselves pay the tuition, market incentives encourage schools to heed their wishes over those of any other group. Unlike government officials in charge of other people's money, parents have an incentive to get what they pay for. "Free" services, including tuitionless government schools, don't elicit the same response. When we receive a free service, we tend to take it for granted and to have lower expectations than we would if we were paying for it ourselves. Two thousand years ago, a lawyer and corruption prosecutor known as Pliny the Younger made this same observation about the spread of government-funded education in the Roman Empire (Coulson 1999, 57). A Canadian legislator voiced the same fear 150 years ago, as that country began its own government takeover of education (Coulson 1999, 247). Nothing has changed. Teachers in public schools are roughly six times more likely than teachers in tuition-charging schools to complain about lack of parental involvement (U.S. Department of Education 1995, tables 26 and 31).

Taken together, these commonsense observations explain much about the history of government schooling in the United States. Prior to the rise of state school systems, enrollment in elementary education was nearly universal, and the authority (and financial responsibility) of parents almost total. As fledgling public schools drew more and more funding from higher and higher levels of government, parents became marginalized. The less power parents had, the less sense it made for them to try to become actively involved in the schools because schools increasingly could ignore the wishes of parents whenever it suited them without suffering the financial consequences such behavior would produce in a tuition-based education marketplace.

With parents and private scholarship programs bearing the cost of education, no government funds are used, and substantial benefits are created. First, tax credit programs need not leap state and federal hurdles that block the use of government funds for religious instruction. The U.S. Constitution, as interpreted by the Supreme Court, permits government funds to pass to religious institutions so long as they pass through religiously neutral and indirect means, but many state constitutions are far stricter, explicitly prohibiting such funding. These state constitutional provisions, called Blaine amendments after their nineteenth-century champion James G. Blaine, originally were intended to discourage Catholic schooling and to entrench the contemporary monopoly of the pervasively Protestant public schools (Jorgensen 1987).

Besides prohibiting states from funding religious schools, some Blaine amendments forbid the compulsion of citizens to support religious institutions. This restriction narrows the wiggle room of voucher programs still further. Even if a voucher is religiously neutral and students receive religious instruction only if their parents choose it, taxpayers are still obliged to support that instruction. The Supreme Court of Wisconsin has worked inexplicable legal magic in upholding the Milwaukee voucher program despite just such a clause, but their dazzling *léger-de-loi* may be difficult to replicate (Coulson 1999, 329–30).

Critics of school choice naturally argue either that tax credits constitute government spending and hence violate Blaine amendments or that they necessitate extensive government oversight. Indeed, such critics have challenged education tax credits on those grounds in Arizona and Illinois. In *Kotterman v. Killian,* the Arizona Supreme Court disagreed, ruling that tax credits are not government expenditures under the legal definition and upholding the Arizona program. The U.S. Supreme Court did not take issue with the Arizona court's reasoning, refusing to hear an appeal of its decision. Two separate Illinois Circuit Court rulings reached the same conclusion, upholding that state's 1999 education tax credit law.[2]

Voucher supporters nevertheless dispute the superiority of tax credits on the legal and regulatory front. A recent article in *School Reform News*—published by the Heartland Institute, of which Joseph Bast is president—is titled "HOPE Tax-Credits Bring Increased Regulation." The HOPE program, created by the Clinton administration, is a national tax credit that parents can take against college tuition payments. The HOPE program is poorly designed in a number of ways: it is a federal rather than a state program, and it necessarily discriminates against the poor. Milton and Rose Friedman demonstrate in *Free to Choose* (Friedman and Friedman 1980) that government aid for college attendance is generally regressive, helping the wealthy and middle classes far more than the poor because poor children, having received abysmal public schooling, are often unprepared for and hence do not pursue higher education. Until our elementary and secondary school system offers high-quality instruction to all children, programs to make college tuition less taxing necessarily will discriminate against low-income families. The HOPE program makes matters far worse because it can benefit *only* families with a net federal income tax burden and therefore necessarily excludes the poorest families.

The HOPE program also imposes new regulations on educational institutions. What the *School Reform News* article does not explain, however, is that these regulations are *not* the sort that interfere with the five key market factors that I listed earlier. The burden imposed by the HOPE program is that schools must report the names, addresses, and Social Security numbers of parents to the Internal Revenue Service (IRS), so that the IRS can curtail fraudulent use of the credits. Reporting this information in no way impinges on the choice or financial responsibility of parents, on the freedom of educators, or on competition and the profit motive for schools. Although we would be wise to design tax credit programs to minimize the time and expense of filing requirements, that issue is a separate and less critical one.

Much more worrisome are regulations that directly or indirectly affect the curriculum and personnel decisions that schools make—regulations such as section

2. The two rulings were in December 1999 (Judge Loren P. Lewis presiding) and April 2000 (Judge Thomas Appleton presiding). The first suit was brought by the Illinois Teachers Federation and the second by the Illinois Education Association, each being the state affiliate of one of the nation's two large public-school teachers' unions (the American Federation of Teachers and the National Education Association, respectively). See Clowes 2000.

3313.97.6 of the Ohio revised code, pertaining to the eligibility criteria for private schools wishing to participate in that state's voucher program. Paragraph (a) 4 of that section states that participating schools must not "discriminate on the basis of race, religion, or ethnic background."

Though well intentioned, this provision may have significant negative consequences. Schools wishing to retain the services of a native foreign-language speaker to teach Chinese or Spanish or to hire a devout Protestant, Jew, Muslim, or Catholic for religion classes might well end up in court for "discriminatory" hiring practices. At least one religious organization has filed a brief with the U.S. Supreme Court opposing the Cleveland voucher program because it believed the program would create just such a burden on religious schools.[3] The nation's many successful African American academies might well be obliged, if they wished to participate in the program, to abandon their special mission of serving black youth. Under a universal voucher program, schools that refused to accept vouchers in order to preserve their independence would be at an enormous disadvantage with respect to "free" voucher-redeeming schools. As already noted, restrictions on who can teach and what can be taught have consistently accompanied state funding of education from ancient Greece and Rome to the modern Netherlands.

The U.S. Supreme Court itself has acknowledged that government funds generally come with strings attached, writing in *Lemon v. Kurtzman,* "The history of government grants of a continuing cash subsidy indicates that such programs have almost always been accompanied by varying measures of control and surveillance" (403 U.S 602 [1971]).

Public schools, of course, already are controlled completely by an astonishingly vast compendium of state regulations. In this regard, could a voucher system be any worse? The real regulatory risk of vouchers is that by extending government subsidies to the private sector, they are likely to extend the suffocating pall of government regulation.

Bast agrees that "the great majority of private schools—virtually every Catholic school—would not hesitate to accept vouchers," but he argues that they would resist the temptation to do so if significant government regulatory strings were attached. This belief ignores the history of education regulation both domestically and internationally. When governments extend funding to schools, they generally do not impose an expansive regulatory burden immediately. More commonly, they present a modest initial burden that expands over time. For example, Maine's tuition program—essentially a voucher for students whose towns do not have public high schools—originally allowed religious schools to participate but reversed that policy in 1983 (Heller 2001).

3. The brief was filed by Adventist attorneys Lee Boothby and Alan J. Reinach on behalf of the Council on Religious Freedom, the Seventh-day Adventist Church State Council, the Northwest Religious Liberty Association, and the Interfaith Religious Liberty Foundation.

The process works much like a ratchet: it is easy to add regulations but difficult to repeal them. The encyclopedic regulatory frameworks that govern modern state school systems did not spring into being fully formed. Rather, they were built up incrementally over more than a century. Rarely has any single twist of the ratchet seemed overwhelming in itself, but the cumulative effect has been stifling.

So although vouchers may take hold initially only if they are minimally regulated, the lessons of the past suggest that they will become progressively more regulated over time. Once private schools have become accustomed to this regular flow of new funding, it will be far more difficult for them to abandon it. With each new regulation, they would have to ask: Is this one requirement worth giving up state funding and jeopardizing the institution's viability?

Another problem with government vouchers, and indeed with all other third-party payment plans, is the potential for fraud. Whenever the person paying for a service is not the one consuming it, fraudulent use of the funds becomes easier. Vouchers, for instance, might be printed for fictitious students. Certainly, voucher programs might impose a range of regulatory safeguards in the hope of minimizing this problem, but the realization of that hope is questionable.

Consider the case of the Washington, D.C., public schools, which are certainly as heavily regulated and monitored as any voucher program would be. In 1995, it was discovered that D.C. schools were billing for eighty-one thousand students when they enrolled only sixty-seven thousand. Or take the case of a Los Angeles public-school administrator who in 1998 admitted to having invented enough mythical students to defraud taxpayers of nearly three quarters of a million dollars (Coulson 1999, 326–27). Neither case is unique. The U.S. Department of Education itself has been home to similar corruption. In the months prior to January 2002, fifteen department employees pleaded guilty to embezzling more than a million dollars (Robelen 2002). Vouchers would present new options for illegal abuses, including kickbacks to parents. The federal food stamp program already has been hit with such a scheme (Coulson 1999, 326–27). Neither kickback nor phantom-student ploys can succeed when parents pay for their own children's education.

Though private scholarship funds are potentially subject to these forms of abuse, they have a unique advantage over government vouchers: with the slightest hint of scandal (or even of simple inefficiency), their tax credit–claiming donors can redirect their funds elsewhere immediately. Under government programs, taxpayers have nowhere else to go. Tax credits thus provide choice not only to parents, but also to taxpayers.

Disadvantages of Tax Credits

All is not sunshine and roses in the land of tax credits. In certain areas, vouchers have greater appeal. First, a universal voucher program is easy to explain in just a sentence or two. The dual tax credit program already described is much more difficult to communicate to the general public, and it prompts more questions for clarification. If people can't understand it, they won't support it. The upshot of this observation is that greater time, effort, and funding must be expended on educating the public about tax credits and that tax credit programs are perhaps better suited to the normal legislative process than they are to one-paragraph ballot initiatives.

Besides being simpler to explain, voucher programs are also simpler to implement in many cases. In states that do not have an income tax, the logistics of tax credits become far more difficult: there is neither a state tax form on which the credit can be claimed nor a clear assessment of the parent's tax burden from which the credit would be deducted (who knows how much state sales tax he pays in a year?).

Even in states with an income tax, a considerable portion of education spending is generally financed through local (usually property) taxes. A parent's state income tax burden by itself, therefore, may not be large enough to accommodate a significant credit.

In view of these difficulties, Bast argues that no tax credit program could produce enough financial assistance to make a real difference to middle-income and low-income parents. That assessment is overly pessimistic. Public schools are financed by local and state taxes, and public schools spend on average approximately twice as much per pupil as private schools charge in tuition. Thus, ample room exists for tax credit programs to ensure universal access to the education marketplace, so long as they are structured properly.

To achieve that goal, two requirements must be met: first, the state tax system must allow middle-income parents to offset the credit against their total tax burden (not just against some portion of it); and, second, an appropriate family-size and income cutoff for the scholarship-donation tax credits must be established to ensure that all families who need scholarships receive them. The first of these requirements will be easier to meet in some states than in others, and it requires careful consideration as states decide between tax credits and vouchers.

When Good People Disagree

The only valid concerns that have been raised against a tax credit program pertain to its initiation: possibly revising the tax code, crunching the numbers, and getting the program enacted. For vouchers, this front loading is not the case. History suggests justifiable concerns about the long-term impact of vouchers on parental choice and the freedom of educators. In the light of historical patterns and the effects of charter-school and voucher programs, it seems likely that most independent private schools would opt to accept vouchers for financial reasons, and hence regulatory encroachment on voucher programs might well serve to expand the state's existing education monopoly rather than to diminish it.

The Dutch example is perhaps the best-case scenario, in which private schools do, for the time being, retain some level of control over the content of their lessons, but government does intervene in this area and others, prohibiting the profit motive and fixing prices.

The worst-case scenario would be U.S. public schooling itself. Before the common-school movement of the mid–nineteenth century, education in this country was largely independent. When government was involved, it was at the local level, and parents remained the dominant decision-making force because most still paid tuition. As funding became centralized at the level of state government, so did control.

Each of us must decide what worries us more: the initial difficulty of designing and enacting tax credits that achieve universal access to the education market or the long-term dangers that vouchers pose—including parental disfranchisement and the usurpation of control by the state.

Steeped as I have been in the historical evidence, perhaps becoming presbyopic as a result, the long-term benefits of tax credits seem to me to outweigh their near-term difficulties. Others, Bast among them, disagree. Adding to the difficulty in forming a position on this subject is the sense that we must to something, almost anything, *now,* with so many children falling into the yawning chasm of government miseducation. So what to do?

I have decided to advocate tax credits over vouchers because the evidence has moved me to that position. I also have decided, however, not to oppose vouchers and indeed to support the expansion of existing voucher programs for two reasons: first, the pressing need to do something; and second, the safety net created by our federal system of government. If I am right about vouchers, states that adopt them may show visible signs of problems that will not arise in states that adopt tax credits or some other policy. So long as we do not impose any one program at the national level, we will have points of comparison that will help us to determine which policies are working well and which are not. One reason that government schooling has been so tenacious despite its failings is that it has dominated every American state for more than a century, and our collective memories no longer recall the day when U.S. education more closely resembled a parent-driven marketplace.

References

Clowes, George A. 2000. Challenge to Illinois Tax Credit Dismissed. *School Reform News* (June). Available at: http://www.heartland.org/education/jun00/credit.htm.

Coulson, Andrew J. 1999. *Market Education: The Unknown History.* New Brunswick, N.J.: Transaction.

Failing our Children: The Department of Education. 2000. May 5. Available at: http://freedom.house.gov/wastewatch/education.asp.

Friedman, Milton, and Rose Friedman. 1980. *Free to Choose.* New York: Harcourt Brace and Jovanovich.

Heller, Frank. 2001. *Lessons from Maine: Education Vouchers for Students Since 1873.* Cato Institute Briefing Paper no. 66, September 10. Washington, D.C.: Cato Institute. Also available at: http://www.cato.org/pubs/briefs/bp66.pdf.

James, Estelle. 1999. The Netherlands: Benefits and Costs of Privatized Public Services—Lessons from the Dutch Educational System. In *Private Education in Ten Countries: Policy and Practice*, edited by G. Walford, 179–99. London: Routledge.

Jorgensen, Lloyd P. 1987. *The State and the Non-Public School, 1825–1925.* Columbia: University of Missouri Press.

Merrifield, John M. 2001. *The School Choice Wars.* Lanham, Md: Scarecrow.

Robelen, Erik W. 2002. Seven More Sign Guilty Pleas in Ed. Agency Fraud Case. *Education Week,* February 6.

U.S. Department of Education. National Center for Education Statistics. 1995. *Digest of Education Statistics, 1995.* Washington, D.C.: U.S. Department of Education.

Vedder, Richard K., and Joshua Hall. 2002. For Profit Schools Are Making a Comeback. *The Independent Review* 6 (spring): 573–83.