Policy Brief The Heartland Institute

June 8, 2011

Corrections to Fiscal Note for Taxpayers' Savings Grants Program

By Joseph L. Bast[1]

Texas Representative Sid Miller introduced HB 33, the Taxpayers' Savings Grant (TSG) program, at the start of the legislature's 2011 Special Session. The Texas Legislative Budget Board (LBB) released its fiscal note on the bill on June 6. The author was asked to review the fiscal note and correct any errors, of which several were found.

Apparently Correct Assumptions

The fiscal note contains several major errors, which this brief corrects.

LBB correctly summarizes the content of HB 33, as it appeared at the time, in its section titled "Fiscal Analysis." Briefly, the bill would allow the parent or legal guardian of a school-age child residing in Texas who was entering kindergarten or first grade or who had attended a public school for all of the prior academic year to receive reimbursement for private school tuition up to the amount of tuition paid or 60 percent of state spending on maintenance and operations (M&O), whichever is less.[2] An amended version of the Bill, submitted on June 7, appears at the end of this memo.

In a section titled "Methodology," LBB updates information on state average per-pupil maintenance and operations (M&O) expenditures, increasing the earlier estimate used by this author and Prof. John Merrifield of $8,572 to $8,801.[3] Since the savings grant is calculated at

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[2] See John Merrifield and Joseph Bast, "Budget Impact of the Texas Taxpayers' Savings Grant Program," *Policy Brief*, April 2011, The Heartland Institute and the E.G. West Institute for Effective Schooling.

[3] Ibid.

60 percent of the M&O amount, the LBB estimates the value of those grants to be $5,281, slightly higher than our earlier estimate of $5,143.

Finally, the LBB reports the Comptroller's Office has estimated its administrative costs to be $4.8 million annually to implement the program. We accept that as an accurate report.

Use of M&O versus FSP Figures

Merrifield and Bast contended that pe-pupil savings to the state whenever a student was moved from a public to a private school would be 40 percent of per-pupil M&O spending, which is the difference between M&O spending and the amount of the savings grant. Using LBB's updated figures, the per-pupil savings would be $3,520.

LBB contends the savings would be the difference between "the average FSP [Foundation School Program] entitlement, " which it reports is $7,750 in 2011, and $5,281, the amount of the savings grant, or $2,469.

LBB does not explain why it chose to use the lower FSP number or how it derived the estimate. We believe it may be subtracting $1,000 per student to account for federal education funds and another $51 in income from miscellaneous items such as vending machines and sale of tickets to event. LBB presents in a table a column showing "Probable Savings (Cost) from Federal Education Funds," which apparently is calculated by multiplying enrollment in the TSG program by $1,000, which LBB says, in a single sentence late in the report, is "the average loss ... per student in federal funds."

It is far from clear to us, however, that the TSG program would cause the state to lose any federal funds. Other experts in the field tell us they are not aware of any other states with school choice programs similar to the TSG having lost any federal funds. We believe this is a mistake on LBB's part that should be corrected in its next fiscal note.

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Later in this *Brief* we present two estimates of state savings, one using average M&O spending and the other using LBB's average FSP entitlement. LBB should be asked to issue a new fiscal note that does not assume the loss of federal funds.

Assumed Enrollment Rate Too Low

LBB reports the "Texas Education Agency (TEA) assumed that one-half of 1 percent of FSP-eligible students (22,545) would choose to attend a private school and take advantage of the rebate in the first year of the program, rising to1 percent of FSP-eligible students (45,753) in FY 2013 and forward." We contacted TEA to confirm that they were the source of this estimate, and were told they did not, in fact, provide this estimate to LBB.

The assumed enrollment rate is dramatically less than what the best available research suggests. Barry R. Chiswick and Stella Koutroumanes, in research published in 1996 in *Research in Labor Economics*[4] and still regarded as the seminal research on this topic, used regression analysis to determine that a $1.00 reduction in private school tuition in 1990 (the year of their data) increased the probability of choosing a private school by 0.0021 percent. Using the Consumer Price Index to adjust for inflation, a dollar in 1990 had a purchasing power of approximately $1.67 in 2011. Therefore, the current value of the C&K coefficient is 0.000021/1.67 = 0.0000125. A $5,143 tuition reduction in 2011 – the amount of the grant that would be provided under HB 33 – would therefore increase the probability of private school enrollment by 6.4 percent (5,143 x 0.0000125).

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Chiswick and Koutroumanes' estimate can be tested against the real-world experience of existing school choice programs. One such program is the Milwaukee Parental Choice Program (MPCP), which began in 1990 with 341 students using publicly funded scholarships to attend private schools. In the current school year, more than 20,000 students are enrolled. The current scholarship amount is capped at $6,442 and is about 45 percent of per-pupil public spending for Milwaukee Public Schools (MPS).[5]

Prior to 1998-99, demand for choice scholarships in Milwaukee greatly outstripped the supply, so the rate at which parents chose to switch to private schools isn't a reliable indicator of parental interest. In 1995, religious schools were allowed to enter the program, but court challenges to the program were not resolved until 1998. In the 1998-99 school year, enrollment jumped to 5,740, or approximately 5.75 percent of MPS enrollment. The following year, enrollment was 7,596, approximately 7.62 percent of MPS enrollment. By 2009-10, enrollment was 20,042, about 24.41 percent of MPS enrollment.[6]

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[4] B.R. Chiswick and S. Koutroumanes, "An Econometric Analysis of the Demand for Private Schooling," Research in Labor Economics, Vol. 15 (1996), pp. 209-237. Since this article was published, Stella Koutroumanes has changed her name to Stella Hofrenning.

[5] John Robert Warren, "Graduation Rates for Choice and Public School Students in Milwaukee, 2003-2009," School Choice Wisconsin, 2011, in "Sources" to introduction by Susan Mitchell, p. 1, http://www.schoolreform-news.org/article/29370.

[6] MPS and MPCP enrollment from Wisconsin Department of Public Instruction, http://dpi.wi.gov/lbstat/mps_enr.html and http://dpi.wi.gov/sms/geninfo.html ("Overall Membership and Payment History"). Note that state estimates differ from numbers reported by the MPS and other sources, which use different methods that include or exclude charter schools, contract schools, part-time students, etc. We use the latest state statistics for both MPS and MPCP enrollments.

In other words, since 1998-99 (when restrictions on participation by religious schools were lifted and legal challenges ended), the Milwaukee program demonstrated enrollment rates similar to what Chiswick and Koutroumanes' analysis would predict.

A second real-world school choice program is the CEO Horizon Edgewood Tuition Voucher Program (ETV).[7] From 1998 to 2008, that program provided privately funded vouchers to parents and guardians in the Edgewood, Texas school district to allow them to enroll their children in private schools. The tuition grant amount ranged from $2,000 to $4,700 and varied according to grade level and whether the school was inside or outside the Edgewood school district. To stay within the program's $52.4 million budget, the 2004-05 to 2007-08 scholarship funding had to be confined to continuing scholarship users.[8]

In the first year of the ETV program, 770 students received scholarships, a number equal to 5.8 percent of enrollment in Edgewood public schools. In year two, participation rose to 888 students, 6.8 percent of public school enrollment. Participation rose steadily to 15.9 percent in 2003-04, the year before scholarships stopped being offered to new students, and then gradually fell as the program was phased out.[9]

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Both real-world examples of school choice support an estimate of approximately 6 percent enrollment in the first year of the program, not one-half of 1 percent, and of even higher enrollment rates in subsequent years, not a flat rate of 1 percent. LBB should be asked to produce a new fiscal note assuming more realistic enrollment rates.

Settle-Up Process and Deferred Savings

LBB claims a delay in savings, combined with the state having to make savings grant payments to parents immediately, would result in a negative impact on the state during the first two years of the program. It says:

> For the 2012-13 biennium, districts would continue to be paid based on the estimates of pupil counts the TEA submitted to the Legislative Budget Board in March 2011, so the savings accrued in FY 2012 would be realized in FY 2013 through the settle-up process and the savings accrued in FY 2013 would be

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[7] John Merrifield, Nathan Gray, Yong Bao, and Hiran Gunasekara, "An Evaluation of the CEO Horizon, 1998-2008 Edgewood Tuition Voucher Program," August 31, 2009, http://www.schoolreform-news.org/article/29359.

[8] Ibid.

[9] Ibid.

realized in FY 2014. The FY 2014 savings would be substantially larger than the other years as districts would receive reduced payments based on the revised student estimates to be made in March 2013 which would take the lower attendance into account in addition to a reduced settle-up from the 2013 school year.

LBB should be asked to produce a new fiscal note when language is inserted into the bill to expedite the settle-up process.

The current school finance model calculates each coming year's enrollment based on the previous year plus an adjustment for projected enrollment growth or decline. Funds are then distributed based on that enrollment analysis. If actual enrollment differs from the projection, districts and the state "settle up" in the next fiscal year. Since the drop in public school enrollment that would be caused by TSG in 2012 was not anticipated by school districts in 2011, LBB thinks it will be 2013 before they will be asked to "settle-up," causing a temporary loss to the state.

We believe a relatively easy legislative fix would require school districts to report enrollment changes to the state sooner and expedite the settle-up process, so savings appear in the same fiscal year as expenses. The wording of the version of HB 33 that LBB considered did not authorize the Comptroller to adopt rules affecting payment schedules. The latest version of the bill, attached to this *Brief*, does. Here is the language:

> <u>(d) Net savings from the program established under this section shall be used to increase funding to all public schools on a per WADA basis. The Comptroller shall adjust payments in order to reconcile amounts due to all schools within the same fiscal year, or one month after, so that savings accruing within the program are recovered and reallocated to the public schools in the same fiscal year.</u>

LBB should be asked to produce a new fiscal note that assumes this expedited settle-up process. Since it is not difficult to envision such a legislative fix, we offer a revised estimate of the impact of the bill here.

Estimated Net Impact to General Revenue-Related Funds

We have "run the numbers" using LBB's estimate of 2011 M&O spending but correcting its erroneous assumptions regarding the loss of federal funds, enrollment rate, and the settle-up process. The results appear in Table 1 below.

The net impact during the first biennium would be either $2.28 billion, using average per-pupil M&O spending as the basis of calculations, or $1.6 billion, using average FSP entitlement. Either estimate is far above LBB's estimate of a loss of $195 million in the first biennium.

Table 1. General Revenue-Related Funds, Five-Year Impact				
			Probable Net Impact to General Revenue-Related Funds	
Fiscal Year	**Enrollment Rate**	**# Students**	**M&O**	**FSP**
2012	5.74	301,634	$1,061,750,117	$744,733,250
2013	6.6	346,826	$1,220,827,661	$856,313,493
2014	8.0	420,395	$1,479,791,104	$1,037,955,749
2015	9.5	499,219	$1,757,251,936	$1,232,572,452
2016	11.0	578,043	$2,034,712,768	$1,427,189,155

Table 1 also forecasts savings for an additional three years, to correct LBB's five-year impact forecast. Working from the experiences of Milwaukee and Edgewood, we estimate enrollment in the first year will be 86.7 percent of the rate in the second year, that the rate in the second year will be similar to what Chiswick and Koutroumanes forecast, and that later years will reflect the growth rate of the Milwaukee and Edgewood programs. Savings to the state are shown to exceed $1 billion in 2014 and then grow larger in each successive year.

Conclusion

The LBB, by using an extremely low enrollment estimate and by assuming the current funding system won't be changed to place savings in the same year as expenses for savings grants occur, produces a fiscal note for HB 33 that forecasts losses to the state in the first two years and then only very small savings.

We conclude the state would save $2.28 billion in the first two years of the program, and growing amounts in every successive biennium.

Using more accurate and realistic estimates of enrollment and assuming the state's payment system is modified, we conclude that the state would save $2.28 billion in the first two years of the program, and growing amounts in every successive biennium.

Amended Version of HB 33

A BILL TO BE ENTITLED

AN ACT

relating to a taxpayer savings grant program.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Chapter 42, Education Code, is amended by adding Subchapter J to read as follows:

SUBCHAPTER J. TAXPAYER SAVINGS GRANTS

Sec. 42.501. TAXPAYER SAVINGS GRANT PROGRAM. (a) In this section:
(1) "Accredited private school" means a school that:

(A) is accredited by an accrediting association recognized by the commissioner to accredit nongovernmental schools in this state; or

(B) has filed an application for accreditation by an accrediting association described by Paragraph (A).

(2) "Eligible student" means a school-age child who resides in the state and who:
(A) is entering kindergarten; or

(B) attended a public school for all of the academic year immediately preceding initial participation in the program.

(b) A parent or legal guardian of an eligible student who agrees to accept reimbursement in an amount that is less than the state average maintenance and operations expenditures per student may receive reimbursement from the state for the tuition paid for the enrollment of the eligible student at an accredited private school in an amount that is the lesser of:

(1) the tuition paid; or

(2) 60 percent of the state average maintenance and operations expenditures per student.

(c) Money from the available school fund and federal funds may not be used for reimbursement under this section.

(d) Net savings from the program established under this section shall be used to increase funding to all public schools on a per WADA basis. The Comptroller shall adjust payments in order to reconcile amounts due to all schools within the same fiscal year, or one month after, so that savings accruing within the program are recovered and reallocated to the public schools in the same fiscal year.

SECTION 2. As soon as practicable, but not later than the 45th day after the effective date of this Act, the comptroller, in coordination with the commissioner of education, shall adopt rules to implement the Taxpayer Savings Grant Program under Section 42.501, Education Code, as added by this Act, including rules to prevent fraud in financial transactions under the program and to determine the net savings resulting from implementation of the program. Such regulations shall reconcile payments to all schools within the same fiscal year, or one month after, so that savings accruing within the program are recovered and reallocated in the same fiscal year.

SECTION 3. This Act takes effect September 1, 2011, if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for effect on that date, this Act takes effect on the 91st day after the last day of the legislative session.

About the Author

Joseph Bast is president of The Heartland Institute and coauthor or editor of 14 books, including *Rebuilding America's Schools* (1990), *Education & Capitalism* (2003), and *Let's Put Parents Back in Charge!* (2005). His writing has appeared in *Phi Delta Kappan*, *Economics of Education Review*, *The Wall Street Journal*, *Investor's Business Daily*, *Cato Journal*, *USA Today*, and many of the country's largest-circulation newspapers. He is publisher of *School Reform News*.