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The Market for School Choice in Indiana

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The American Enterprise Institute

AEI Education Policy Working Paper 2012-1

November, 2012

Introduction and Background

The Indiana Choice Scholarship Program has the potential to be the largest school voucher program in the country. Though the authorizing legislation capped enrollment in the program at 7,500 for its first year (the 2011-12 school year), that cap was increased to 15,000 for this year, and will be removed for all subsequent years. With careful management, the program has the opportunity to infuse the Hoosier state with a level of choice previously unrealized across the nation. However, without some careful planning and thoughtful consideration of salient program design details and the informal market infrastructure necessary for the program to thrive, the Indiana Choice Program will not be able to reach its full potential.

Private school choice in the United States, writ large, has not sparked the types of systemic changes that advocates envisioned when the first choice plans were enacted. Though the gold-standard analyses of choice programs have found positive resultsⁱ, they have been modest and mostly confined to the students participating in the program. When Milton Friedman first made the economic argument for school choice in the 1950sⁱⁱ he envisioned choice and competition increasing quality and decreasing cost for education in both the public and private sector, as it has in the private markets of innumerable goods throughout history. However, it appears that for a variety of reasons, choice has not sparked the supply side responses that the economic models predicted.

Why has this happened? Why has choice failed to live up to its hype? In short, functioning choice markets do not simply emerge from the ether. They must be

cultivated, both on the demand and supply sides. Too often, advocates have pushed an “if you build it, they will come” program design that has neglected many of the necessary conditions for markets to function. Strong program design can establish the playing field on which choice and competition can drive change, but without the support of institutions and organizations within states, the innovative capacity of any program will be greatly curtailed.

In this way, the Indiana Choice Scholarship Program can serve as an interesting case study in the cultivation of choice markets. The newness and enormous potential of the program offers a unique opportunity for a meaningful conversation on school choice markets, both how to design them and how to ensure that they function. By examining both program design and the emergence of the institutions and organizations that are necessary to make markets work, we can use the Hoosier State as a model for the potential for choice programs around the country.

The Indiana Choice Program

The choice programⁱⁱⁱ provides scholarships to eligible students based on a somewhat complicated formula.

-In order for a student to receive a *full* scholarship – valued at whatever is least between tuition and fees at a qualifying public school, 90% of state support of per pupil spending, or \$4,500 for grades 1-8 – the income of a student’s family must not exceed 100% of the eligibility threshold of the federal free or reduced-price lunch program (which in 2011-12 was \$41,348 for a family of four).

-In order for a student to receive a *partial* scholarship – valued at whatever is least between tuition and fees at a qualifying public school, 50% of state support of per pupil spending, or \$4,500 for grades 1-8 – the income of a student’s family must not exceed 150% of the eligibility threshold of the federal free or reduced-price lunch program (\$62,021 in 2011-12).

It is important to take a moment to fully unpack what is meant by “state support”. Public schools are funded by a combination of local funds, state funds, and federal funds. Local funds usually come in the form of property tax revenue, state funds usually come from a combination of sales and income taxes, and federal funds come from income taxes. A good rule of thumb is that most districts are funded approximately 50% from local funds, 40% from state funds, and 10% from federal funds, though districts that have low property values will see larger portions from state and federal coffers. Therefore, in Indiana, the scholarship is not valued at 90% or 50% of the total per pupil allotment for students (which on average was just over \$9,600^{iv}), but rather 90% or 50% of that 40% contributed by the state. The local and federal dollars earmarked for that student continue to go to the public school to which that student would have attended if he or she did not participate in the program.

Students and schools must also adhere to a variety of regulations in order to participate in the program. First, students must have attended a public school for the most recent two semesters before applying to the program, or must have received a Corporate or Individual Scholarship Tax Credit for the previous year. The tax credit

program is a voucher-like program that gives tax breaks to individuals and corporation that contribute to one of the four private-school scholarship granting organizations who then disburse scholarships to eligible students. This provision ensures that the program will not represent any new expense in the short term by only serving students already in the public sector, something that was a priority for Governor Mitch Daniels when the economy contracted in the Great Recession^v.

Schools must be accredited by the state of Indiana or by a recognized accrediting agency and must administer the state end-of-course examinations (the ISTEP). Schools must also participate in a modified version of the states accountability program, with schools receiving a “D” or “F” for two consecutive years no longer able to accept new voucher students.

In 2011-12, 3,919 students attended 241 different schools as a result of the program. In 2012-13 over 9,300 students participated.

I conducted eight semi-structured interviews with individuals affiliated with the program to better understand how students and schools had participated in the program in its first year, and to understand where the program is headed in the upcoming years. These individuals represented three different groups affiliated with the program: advocates, school leaders, and employees of the state Department of Education. The conversation was framed by my desire to determine why students and schools chose to participate, why they chose to participate to the level that they did, and why other students and school chose not to participate in the program.

Stumbling Blocks

Unequivocally, across all interviews, those involved with the voucher program believed that, with its current structure, the program *will only serve to fill excess capacity in schools, not drive the creation of new schools*. This has occurred for three major reasons: the low value of the voucher (coupled with the high transaction costs of participating in the program), the prior year enrollment requirement, political instability surrounding the program.

1. **Low Voucher Amount.** As described above, the voucher has a maximum value of \$4,500, but often several hundred dollars lower based on the formula calculation. Given that, on average, Indiana spends just over \$9,600 per pupil per year, voucher funding falls well below what is traditionally spent to fund a child's education.¹ Any school that takes voucher students would have to commit serious time, energy, and manpower to raise funds to adequately meet the gap between the voucher amount and the cost to educate. Large schools that already have a fundraising apparatus in place are able to do this; smaller schools struggle. Similarly, new school providers are reluctant to enter this space if they know that from the beginning they are going to operate at a loss. New schools have serious capital needs and startup costs that are not covered by voucher programs, and are an almost insurmountable hurdle to new schools entering the

¹ As a point of reference, according to the National Catholic Education Association, the average cost to educate a student in a Catholic elementary school nationwide is \$5,387 per year and the average cost to educate a high school student in a Catholic school is \$10,228¹. Catholic schools have a reputation for running cost effective and efficient organizations, so if the voucher amount falls below what even they spend, it is likely too little to meaningfully provide for a student's education.

market. In short, there are serious transaction costs in meaningfully participating in the program, from marketing to find new students to supporting students that schools had not traditionally served, and a \$4,500 voucher will simply not cover those.

- 2. Prior Enrollment Requirement.** The fact that students had to be enrolled in public schools the year before starting the voucher program greatly constricts the market for private school choice. First, private schools in Indiana are filled with students that qualify financially for the program and struggle to pay tuition. Most schools can supplement the contribution that families can make with financial aid, but this aid is finite. If the students that currently receive financial aid instead received vouchers, the money being spent to finance their education could be used to close the gap between the voucher amount for that student and, most likely, for several others. Instead, financial aid is subsidizing students that qualify for aid, but are disqualified because they attended the school the year before. Second, the prior enrollment requirement creates a strange pipeline for students entering schools. Pre-kindergarten does not count as a “prior year enrollment” so as the law is written, students have to attend public kindergarten if they want to get a voucher for the first grade. Schools cannot ever manage the entire education of one student.² It is widely documented that the earliest years are the most important in a child’s development, so not allowing students to

² There is a “loophole” in the law that allows students that received tuition tax credits to count that year as the public school prior enrollment, but in the entire state last year only 590 students used those scholarships. Also, the entire tax credit program has a cap of \$5 million in funding, greatly limiting the number of students that can take advantage of its opportunity.

attend the school they choose in that first year is bad for both students and schools.

3. **Political instability** is causing many groups to take a “wait and see” approach in deciding to participate in the program. Schools believe that taking in a student is a commitment to that student from the moment he walks through the door to the day of graduation. Many school leaders are concerned that the political uncertainty that surrounds the program might cause schools to renege on that commitment if the legislature cancels funding for the program or a future governor halts the program. New school providers, on the same note, are reluctant to enter a marketplace that might not exist in the upcoming years. With the split in the 2012 election between the generally friendly state house and governorship and the most likely less friendly state superintendent’s office it is unclear as to the long term stability of the program. While the governor and legislature will most likely be able to protect the core facets of the program, the state superintendent has plenty of leverage to regulate the program in such a way as to prevent more operators from entering the space.

Stumbling Blocks for others that are Not Stumbling Blocks Here

Other voucher programs have, at times, been stifled by requirements of school accreditation, by the onerous requirements placed on entrance lotteries, and by uncooperative state-level administrative institutions. In the case of the Indiana Choice Scholarship Program, these have not been particularly difficult hurdles to overcome.

These cases make an interesting point; what are stumbling blocks in some states are not stumbling blocks in others.

1. **Accreditation.** To be accredited by the State of Indiana, a school must agree to participate in the ISTEP, the state end-of-course exams. In other states, most notably Wisconsin, there has been and continues to be debate as to whether or not students should have to take the same state exams.^{vivii} This has not been the case, by and large, in Indiana. As it turns out, to participate in sports in Indiana, a school has to be accredited by the state and take the ISTEP, so most schools have been doing it for years. Though this mostly affects high schools' participation in the ISHSAA (Indiana State High School Athletics Association) it appears that participation in state accreditation has trickled down into middle schools and elementary schools over the course of the last several decades. Accreditation for private schools is made easier due to a special "freeway" accreditation process that exists for schools that are already accredited by another body. According to a school leader of a large high school that participates in the voucher program, this streamlined accreditation process makes state accreditation a half-day a year affair. Schools have a multi-year tradition of participating in state accreditation, and thus it simply has not been a hurdle for schools to participate in the program.
2. **Lotteries.** Much like accreditation, in other state voucher programs, schools and families have pushed back against lotteries that make admission into participating schools "blind" and based on chance. This has not been a much of

an issue in Indiana. Because of the newness of the program, very few schools have actually been oversubscribed with voucher students. But even for those that are oversubscribed, the particular requirements of how lotteries must be conducted still allow private schools wide latitude in controlling admission to their schools. Schools are free to set admission criteria, so even students participating in the lottery for admission have to meet the entrance requirement of the school; it is not truly “blind” like a charter school lottery.

- 3. The state-level administration of the program.** The State of Indiana elects their Superintendent of Public Instruction. Former superintendent, Dr. Tony Bennett, was instrumental in passage the voucher legislation and is a full throated supporter of the program. Therefore, the state bureaucracy charged with implementing and overseeing the program was supportive of the program and encouraged its expansion. However, with his recent ouster, the bureaucracy could very well become a lot less friendly. Indiana might start to look more like Wisconsin, whose state superintendent went so far as to say (referencing the Milwaukee Parental Choice Program) that “spend[ing] hundreds of millions to expand a 20-year-old program that has not improved overall student achievement, while defunding public education, is morally wrong”.^{viii} A friendly institutional environment in Indiana engenders confidence on the part of schools and facilitates open dialogue and collaboration between the state and the schools, something that is lacking in choice programs elsewhere.

Discussion

In total, Indiana represents quite clearly the limitations of selling vouchers as cost savers in the short run. In order to implement a voucher program that does not represent a large initial expense, participation has to be limited to students that were enrolled in public schools the previous year. If any of the tens of thousands of financially eligible students that currently attend private schools were allowed to participate in the program – that is, receive government funding this year when they did not receive it last year – there would be a huge spike in the cost of public education in the state. The truth of the matter is that private schools in Indiana save hundreds of millions of dollars by educating students at no cost to taxpayers. If that private education suddenly became subsidized by taxpayers, those hundreds of millions of dollars in savings would evaporate.

Similarly, in order to save money in the short term, the voucher amount needs to be set below what traditional public schools are spending. In actuality, while this does move the burden of the cost of educating students away from the taxpayer, it simply moves it to the fundraisers for private schools that have to meet the gap between what the voucher funds and what it actually costs to educate a student in the school. A voucher of \$4,500 may cover the marginal cost of adding a few students to a relatively lean and mean elementary school, but it in no way covers high school costs or comes close to contributing to the fixed costs of opening or expanding voucher-receiving schools.

Saving money in the short term should not be the goal of a school voucher program. The logic of school voucher programs, from the guidance of Milton

Friedman to today, is to change the incentives and organization of schools to promote innovation and efficiency. In Indiana today, schools that wish to enter the market or expand to meet the needs of more students are fighting with one hand tied behind their backs. Indiana will never see the types of supply side responses that Dr. Friedman imagined when the funding level is so low and the students that can participate are so restricted.

Indiana also needs more organizations to support nascent school development. The transaction costs of starting a new school or expanding an existing school are extremely high. There needs to be substantial fundraising and planning that most schools are not in a position to do well. Right now, there are organizations in Indiana to help schools (most notably the Indiana Nonpublic Schools Association and School Choice Indiana) but their work has been limited, primarily, to helping with compliance and advocating for the program to the public and state legislature. While these are undoubtedly important roles to play, they are not going to help develop new capacity to serve students. There is great potential for new organizations to come into Indiana and lower some of the transaction costs of new or expanding schools. Organizations that can help provide fundraising capacity or long-term planning assistance to schools would be helpful, and could serve many schools at once, leveraging economies of scale to be efficient and effective.

Developing a lasting political coalition has been an issue in choice programs across the country, and Indiana is no different. While today there exists a strong legislative coalition to support the program, there remains a minority committed to

eliminating the program. This group will always be a wolf at the door, making education providers nervous about choosing to participate in the program. Schools want to commit to years of education for students, but cannot be sure that the funding will follow that child for the whole time period. Similarly, school providers that want to get involved will not do so if they worry that their funding will dry up and they will be forced to close. Broadening the support for choice will be an essential element of supply side cultivation as the program moves forward.

Recommendations

- 1. Increase the voucher amount.** Quite simply, a best-case scenario of \$4,500 per student is not going to encourage new entrants into the provider space. As the program is limited in the number of students that can participate, effectively limiting participation to schools that are established enough to be able to accommodate students at a loss is (perhaps inadvertently) a way to build the program sustainably. We know from the charter school literature^{ix} that new schools tend to struggle through several years of growing pains before increasing student achievement, so starting the program with schools that do not have to go through these growing pains can develop some momentum that can help push the development of new schools. However, this momentum will go nowhere if an entirely voucher or majority voucher school model is not financially sustainable. The voucher amount will need to increase if these types of schools are desired.

- 2. Remove the prior enrollment requirement.** Schools, especially those that are brand conscious and confident in their product, want to teach students for their entire educational career; this is why the majority are K-8 schools, not mixed elementary and middle schools. Forcing at least one of those years to be sacrificed to a school that the student does not want to attend, especially when a private school is willing to educate that student, is not only an inefficient allocation of resources, but also damaging for students that wish to participate in the program. For schools that are conscious of the long-term development of students, or wish to implement a particular curricular model (classical, technology-focused, etc.), having to enroll students that have already been in public schools is suboptimal and might discourage participation.
- 3. Develop school “incubators”.** As previously stated, large existing private high schools have the fundraising capacity to close the gap between voucher funding and the total cost to educate students. Small schools and startup schools wishing to enter the marketplace do not. There is clearly room for an outside organization to enter the space to help “incubate” these startup schools, not unlike the numerous business incubators that exist around the country for startup companies. This could help schools develop the initial capacity for fundraising, planning, and management and lower the transaction costs of developing the personnel that schools would need to meet these needs.
- 4. Develop start-up grants or low/no interest loans for new schools.** Should the value of the voucher not increase, or not increase to be able to support the up-

front capital costs that new providers would incur, either the state or local foundations or philanthropists could offer grants or loans to cover startup costs. Schools, to a point, can exploit economies of scale to drive per-pupil costs down, but it takes time to bring enrollment to that level. Schools should be able, if they successfully meet student needs, to build enough of a surplus to repay loans with reasonable terms several years into operation.

5. **Work purposefully to develop a broad political constituency to support the program.** Unlike many other voucher programs that set enrollment caps or participation caps that restrict enrollment to small numbers of poor students, the Indiana program extends eligibility to a large number of students whose family income extends well into the middle class. This represents an opportunity to develop a large, powerful voting constituency that can protect the program regardless of who is elected in Indianapolis. Choice advocates, school leaders, and interested politicians would be served well to coordinate and support the efforts of any of the pro-school choice education reform advocacy organizations that organize parents, support candidates, and educate voters on pertinent issues.
6. **Stop selling the program as a short term cost saver.** It was important politically to sell the voucher program as a way to save the state money in a time of immediate tight budgets. However, continuing to stick to that motivation as a guiding principle will hamstring the program's growth. Long term, even with a higher voucher amount and a lack of a prior enrollment requirement, the

systemic changes of market forces should see a decrease in the overall cost of public schools. Allowing students already in private schools to benefit from the program will build the political constituency that will support and protect the program.

Conclusion

We end where we began, by stating that the Indiana Choice Program has the potential to be the largest and most diverse manifestation of school choice in America. The potential for diverse providers to enter the state to meet students' needs in new ways is enormous. The demand, several thousand students strong, is there. However, without some important and necessary adjustments to the way in which the program is administered, and to the types of organizations present to help develop schools, there will be serious hurdles that will prevent quality providers from entering the space. By fundamentally changing the motivation and marketing of the plan from one of short-term cost savings to long-term reorientation of the way the Hoosier state provides education, the variety of options available for students in Indiana should greatly increase.

Favorable conditions for a market are only one part of the equation. Once the playing field is set up, someone has to train the team. This is an underdeveloped facet of the Indiana Choice program. Indiana has an institutional advantage over most states in that the state education bureaucracy is supportive of the program. However, while organizations exist to support schools, they are limited in their scope and budget and will not be in a position to meet the needs of an increasing number of schools. Those

supportive of the program would serve it well to encourage outside organizations to come to Indiana to help with the needs of startup and expanding schools. If that takes place, the Indiana Choice Program can be both a model of school choice policy and a model of school choice practice, something the Hoosier state can be very proud of.

ⁱ Forester, Greg (2011) *A Win-Win Solution: The Empirical Evidence on School Vouchers*. Indianapolis: The Foundation for Educational Choice.

ⁱⁱ Friedman, Milton (1955) "The Role of Government in Education" in *Economics and the Public Interest* ed. Robert Solo. New Brunswick: Rutgers.

ⁱⁱⁱ Salient program details culled from the Alliance for School Choice's 2011-12 yearbook available at <http://www.allianceforschoolchoice.org/yearbook>

^{iv} U.S. Census Bureau Report "Public Education Finance: 2010" CNN Money, available at <http://www2.census.gov/govs/school/10f33pub.pdf>

^vIsidore, Chris (2011) "Indiana: An island of calm in state budget storms" http://money.cnn.com/2011/02/14/news/economy/mitch_daniels_indiana_state_budget/index.htm

^{vi} Evers, Tony and Howard Fuller (2011) "Voucher program needs accountability" The Milwaukee Journal Sentinel, available at <http://www.jsonline.com/news/opinion/121810724.html>

^{vii}Hetzner, Amy (2011) "Walker: Voucher school results show need to promote successful schools" The Milwaukee Journal Sentinel, available at <http://www.jsonline.com/blogs/news/119020929.html#!page=4&pageSize=10&sort=newestfirst>

^{viii} Herzog, Karen (2011) "Evers calls voucher expansion 'morally wrong' in Memo" The Milwaukee Journal Sentinel, available at <http://m.jsonline.com/more/news/wisconsin/122451333.htm>

^{ix}CREDO (2009) *Multiple Choice: Charter School Performance in 16 States*. Stanford University Center for Research on Educational Outcomes, available at, http://credo.stanford.edu/reports/MULTIPLE_CHOICE_CREDO.pdf