Policy Analysis

CATO INSTITUTE

January 20, 2016 | Number 785

Taking Credit for Education

How to Fund Education Savings Accounts through Tax Credits

By Jason Bedrick, Jonathan Butcher, and Clint Bolick

EXECUTIVE SUMMARY

Every child deserves the chance at a great education and the American dream. Unfortunately, decades of student achievement data reveal that the increasingly costly U.S. district school system does not provide an excellent education for all students. State lawmakers around the country are now seeking ways to enhance the ability of families to choose among not only schools, but online classes, personal tutors, and other educational service providers.

Lawmakers in five states have passed laws allowing eligible students to receive an Education Savings Account (ESA) instead of attending their assigned district school or a charter school. Under these ESA laws, the state deposits public funds into private bank accounts that parents can use to purchase a variety of educational products and services.

However, nearly 40 states have constitutional provisions prohibiting the use of public funds at religious schools. These so-called Blaine amendments were originally motivated by anti-Catholic sentiment more than a century ago. State courts have interpreted some Blaine amendments in a manner that may pose an obstacle to private-school-choice laws, including ESAs. Fortunately, lawmakers can design ESAs to avoid such constitutional issues.

This paper will explain how legislators can design an ESA that is privately funded through tax-credit-eligible contributions from taxpayers, similar to tax-credit scholarship programs around the country. Tax-credit-funded ESAs would empower families with more educational options while enhancing accountability and refraining from coercing anyone into financially supporting ideas they oppose. Because they are funded through voluntary contributions rather than public funds, tax-credit scholarships have a perfect record of constitutionality at the U.S. Supreme Court and at every state supreme court that has considered the issue. In Blaine amendment states, tax-credit ESAs could be a lifeline to families in need.

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INTRODUCTION

Fifty million students attend U.S. district schools. Although some states and localities allow families some measure of choice, the U.S. Department of Education reports that 73 percent of U.S. students attend the district school they were assigned based on the location of their home.[1] Still, for most low- and middle-income families, there are no financially viable alternatives. These parents have nowhere to turn when their children's assigned school fails to meet their needs.

In order to break the link between education and housing and to empower families to choose the education providers that best meet their children's needs, policymakers in dozens of states have explored various educational choice policies. The three most common forms of private educational choice policies are school vouchers, tax-credit scholarships, and, most recently, education savings accounts (ESAs).

- **Vouchers:** Private school vouchers are coupons that the state provides to help families cover the cost of private school tuition. Since Wisconsin lawmakers granted school vouchers to Milwaukee students in 1990, lawmakers in 11 states plus Washington, D.C., and Douglas County, Colorado, have enacted similar laws.[2] More than 140,000 students received school vouchers in the 2014–15 school year.
- **Tax-credit scholarships:** As with school voucher programs, tax-credit scholarships (TCS) help families pay for private school tuition. However, unlike vouchers, TCS programs are privately administered and funded through voluntary contributions. A TCS law grants a full or partial tax credit to individual and/or corporate taxpayers in return for contributions to nonprofit scholarship organizations. These organizations help families enroll their children in the schools of their choice. As of the 2014–15 school year, more than 200,000 U.S. students were receiving tax-credit scholarships in 14 states, and two new states enacted similar laws this year.[3]
- **Education savings accounts:** ESAs are restricted-use bank accounts that families can use to purchase a wide variety of educational products and services, including personal tutors, online classes, educational therapies, textbooks, and homeschool curricula, in addition to (or instead of) private school tuition. Funds roll over from year to year so parents can save for future educational expenses, including college. In the five ESA programs enacted thus far, the state deposits a portion of the funds that would have been spent on the child in the public school system into the ESAs several times each year. More than 5,000 students are using ESAs in the 2015–16 school year. This paper will explain how education savings accounts can be funded through tax-credit eligible donations instead of from a state's general fund.

The *New York Times* has called education savings accounts a "redefinition of public education" and the *Wall Street Journal* has praised them for "empowering parents to make decisions" about their children's education.[4] In 2011, Arizona became the first state to enact an ESA law. Although eligibility was originally limited to students with special needs, Arizona lawmakers subsequently expanded eligibility to include adopted children, children of active-duty military personnel, students living on Native American reservations, and students assigned to a district school with a D or F rating, as well as siblings of eligible students.[5] Incoming kindergarten students that meet any of these criteria are also eligible to apply, along with preschool children that have special needs.

In 2014, Florida lawmakers enacted an education savings account law for students with special needs.[6] As of the 2015–16 school year, 2,400 Arizona students and about the same number of Florida students used such accounts (called Personal Learning Scholarship Accounts, or PLSAs, in Florida).[7] In the 2015 legislative session, Florida lawmakers tripled the state's appropriation for PLSAs, and more than 5,000 students still could apply for an account in the 2015–16 school year. Also in 2015, Mississippi and Tennessee enacted ESAs for students with special needs, and Nevada became the first state to enact a nearly universal ESA that allows all students attending a public school to apply for an account.[8]

Education savings accounts afford parents unprecedented flexibility to find high-quality schools and services for their children. As policymakers seek to expand educational choice in their states, they should learn from the experience of other states and be prepared for potential challenges. As discussed at greater length in the Constitutional Issues section below, teachers' unions and other groups regularly attempt to use the courts to block parents' ability to choose how and where their child learns. However, it is possible to design an ESA program that is privately funded with the aid of a tax credit that should pass constitutional muster in nearly every state.

To better understand the different ways policymakers can design education savings account programs, we provide three case studies: Arizona's publicly funded and managed ESA program, Florida's publicly funded and privately managed ESA program, and New Hampshire's privately funded and managed tax-credit scholarship program—the only one of its kind that covers homeschooling expenses. We then explain how to design an ESA program that is funded via tax-credit-eligible private contributions to scholarship organizations, instead of through a state's general fund. Finally, we explore the constitutional challenges for parental choice programs in states with certain constitutional provisions and explain why tax-credit-funded educational choice laws have a perfect record of constitutionality at the U.S. Supreme Court and at every state supreme court that has addressed the matter thus far. In addition, the paper includes a list of resources on ESAs, such as reports on how Arizona parents have used their ESAs, a satisfaction survey of Arizona ESA parents, and other reports and essays discussing the economic theory behind ESAs and how to design and implement ESA programs.

CASE STUDIES: EDUCATION SAVINGS ACCOUNTS IN ARIZONA AND FLORIDA

The existing Education Savings Account laws differ in their particulars, but the central concept is the same: families can use an ESA to purchase multiple educational products or services in addition to—or instead of—private school tuition.

Parents of eligible children apply for an Education Savings Account instead of enrolling their children at their assigned district school or at a public charter school. Parents complete an application with a state agency or private nonprofit entity that administers the accounts. Once the agency approves an application, the state awards the family a bank account that can be used for eligible educational expenses. The state deposits public funding in the account at predetermined intervals (e.g., quarterly, as is the practice in Arizona). Key differences in program administration and accountability systems in Arizona and Florida are detailed below.

Arizona's Empowerment Scholarship Accounts

Arizona's Education Savings Account system is administered by the Arizona Department of Education and the state treasurer. Eligible Arizona families interested in an ESA must complete an application that the state department of education makes available on its website.[9] As explained above, Arizona's law limits eligibility to children with special needs, students in failing schools, children adopted from the state foster care system, children of active-duty military personnel, and children living on Native American reservations. To be eligible, children who meet any of these criteria must have been enrolled in a public school

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> **"Parents use the [ESA debit] card at participating vendors, such as private schools, tutoring services, or educational therapists, or use PayPal to make purchases online."**

or be entering kindergarten. Preschool children with special needs are also eligible, along with the siblings of any students eligible for an account.[10]

If the department verifies eligibility and approves an application, the agency sends a contract to the applicants detailing their rights and responsibilities. Once parents sign the contract, the department opens a bank account for the student, and families have the responsibility for educating their child using the new account. The parents are issued restricted-use ESA cards, which function like debit cards linked to personal bank accounts.

The department of education and state treasurer coordinate deposits to the cards quarterly, beginning in August, at the commencement of the academic year. Parents use the card at participating vendors, such as private schools, tutoring services, or educational therapists, or use PayPal to make purchases online for textbooks or for payment to virtual schools. Arizona law allows families to use the accounts for any of the following educational expenses:

- Tuition or fees at a qualified school
- Textbooks required by a qualified school
- Educational therapies or services from a licensed or accredited practitioner or provider
- Tutoring or teaching services provided by an individual or facility accredited by a state, regional, or national accrediting organization
- Curricula
- Tuition or fees for a nonpublic online learning program
- Fees for a nationally standardized norm-referenced achievement test, an advanced placement examination, or any exams related to college or university admission
- Contributions to a Coverdell education savings account
- Tuition or fees at an eligible postsecondary institution
- Textbooks required by an eligible postsecondary institution
- Fees for management of the empowerment scholarship account by firms selected by the state treasurer
- Services provided by a public school, including individual classes and extracurricular programs
- Insurance or surety bond payments as required by the department of education[11]

Families must keep the receipts from all of their purchases and return the receipts to the Arizona Department of Education at the end of the fiscal quarter. The department reviews the receipts to make sure all of the purchases were for eligible educational expenses before making the next quarter's deposit.[12] The department will withhold money if they find that a family has misused their child's account.

The state department of education is responsible for most of the education savings account program implementation. The agency develops rules for the accounts and communicates via email and semi-regular meetings with new applicants and existing account holders.

Florida's Personal Learning Scholarship Accounts

In Florida, lawmakers opted for a different design. Instead of having the Florida Department of Education run the program, lawmakers allowed the two private scholarship-granting organizations operating in the state to administer the accounts (the state agency has oversight responsibilities, including maintaining a list of approved education providers).[13] The primary organization is Step Up for Students, the nation's largest and oldest scholarship-granting organization to operate under a tax-credit scholarship law. Since 1998, Step Up has provided low-income students with hundreds of thousands of scholarships funded by corporations' charitable contributions.[14] Since 2014, AAA Scholarship Foundation, which operates in several other states, has also issued tax-credit scholarships and managed ESAs in Florida.

A CLOSER LOOK: THE MACIAS FAMILY

Perla Macias could tell that her son Albiery was not getting enough attention in his classroom. Albiery's assigned district school in Phoenix, Arizona, earned a D on the state's report card system, meaning it was one of the lowest-performing schools in the state. "It was sad," lamented Perla, "He didn't even want to go to school some days."

Perla knew her son deserved better. Fortunately for the Macias family, Arizona is one of the growing number of states with educational choice programs that empower parents to select the education providers that best meet their children's needs.

Since Albiery was assigned to a failing school, he qualified for an education savings account. In Arizona, parents receive a restricted-use debit card linked to the accounts to pay for eligible educational expenses. Perla used the ESA funds to pay for private school tuition at a new school, where Albiery is thriving. "He is more relaxed in class," Perla explains, and "when he leaves class at the end of the day, I see him hanging out with other kids and smiling." His new school has cultivated Albiery's interest in architecture, and Perla wants to use his account to "support him in whatever school he wants to go to" now and in the future.

Florida's ESAs, called Personal Learning Scholarship Accounts, differ from Arizona's ESA program in several key areas.

First, Arizona's ESAs are funded through the state's public school funding formula, but Florida's program is funded using a separate appropriation. This year, Florida lawmakers appropriated $53.4 million for the accounts, which triples the number of PLSAs that can be awarded from 1,800 to nearly 5,400.[15] Although Arizona's ESA program does not have a cap on how much money can be appropriated to the program, there is a cap on how many new students can participate each year equal to 0.5 percent of total public school enrollment (approximately 5,500 students).[16] The cap sunsets in 2019.

Second, Florida's accounts are available to a subset of children with special needs (the specific diagnoses are included in state law), while Arizona's program is available to all children with special needs who would qualify for an Individualized Education Plan or a 504 plan, as well as the several additional categories detailed above.[17] (A 504 plan is a plan developed to provide appropriate accommodations for K–12 students with special needs attending public schools, as detailed in Section 504 of the Rehabilitation Act of 1973.)

Third, Florida families do not use debit cards or prepaid spending cards, as in Arizona.[18] In Florida, parents log into their account via a website and describe the purchase they intend to make. Once the purchase is approved, parents can spend their own money, and then apply for a reimbursement, which Step Up or AAA pays back to them from their child's PLSA. For larger purchases, such as private school tuition, parents can authorize a tuition payment online, and Step Up for Students or AAA will pay the school electronically from the child's PLSA.

Fourth, and most importantly for the purposes of this report, Florida's program is operated by private, nonprofit scholarship organizations, while Arizona's state department of education administers the program for that state.

This fourth point is a critical difference. Step Up for Students designed an enrollment system for the accounts and promoted the accounts to interested parents at a rapid pace after Florida Governor Rick Scott signed the law. In the program's first year, Step Up met the cap on participating families. In Arizona, the department has not launched a coordinated marketing campaign, and although the number of accounts in Arizona has doubled every year since inception, Arizona has not reached its participation cap.[19]

Since Step Up's primary mission is to award private school scholarships to students, the organization already had a network of fami-

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Table 1
Arizona Empowerment Scholarship Accounts and Florida’s Personal Learning Scholarship Accounts, Key Provisions

	Arizona	Florida
Funding	State General Fund	Annual Legislative Appropriation
Participation cap	No program cap. New participants limited to 0.5 percent of the public school population (approximately 5,500 students) each year until 2019.	Approximately 5,400 students (cap is set according to amount of money appropriated to the program)
Number of participants (2015–16 school year)	2,406	2,400 (est.)[a]
ESA participation as a percentage of public school enrollment	0.21 percent	0.09 percent
Administration	Arizona Department of Education	Qualifying nonprofit scholarship organizations with oversight from the Florida Department of Education
Eligibility	Students with special needs; students assigned to failing public schools; adopted children; children from active-duty military families; preschool students with special needs; students living on Native American reservations; kindergarten students that meet any one of these requirements and siblings of any eligible student	Students with specific diagnoses of special needs (autism, Down syndrome, Prader-Willi syndrome, Spina bifida, Williams syndrome, or other intellectual disabilities as defined by law)
Account Use	Pre-loaded Visa cards	Reimbursement/direct payment from a scholarship organization to a participating vendor

Source: See Arizona State Legislature, “Title 15—Education,” Chapter 19, 15-2401 to 15-2404, http://www.azleg.gov/ArizonaRevisedStatutes.asp?Title=15; Florida Senate, 2014 Session, “CS/CS/SB 850: Education,” https://www.flsenate.gov/Session/Bill/2014/0850; Arizona Department of Education, “Empowerment Scholarship Account Handbook,” http://www.azed.gov/esa/files/2013/08/esa-parent-handbook.pdf; and ESA participation as a percentage of public school enrollment, based on 2015–16 projected enrollment figures, from National Center for Education Statistics, “Table 203.20, Enrollment in Public Elementary and Secondary Schools, by Region, State, and Jurisdiction: Selected Years, Fall 1990 through Fall 2023,” https://nces.ed.gov/programs/digest/d13/tables/dt13_203.20.asp.

[a] Step Up for Students, interview by Jonathan Butcher, October 5, 2015. Florida is due to fund another 600 accounts, bringing the total to 3,000. Florida does not have an application deadline, and Step Up intends to enroll students until the appropriation is met.

lies and interested advocacy groups that could help attract new applicants to Florida’s ESA program. This gave the organization an advantage in attracting new students to the accounts that Arizona’s department of education did not have when Governor Jan Brewer signed Arizona’s ESA law five years ago. This advantage may be one reason why more than 3,700 families applied for Florida’s accounts in the program’s first year, while only 75 families applied for Arizona’s program when the department opened the application process in 2011.[20]

A CLOSER LOOK: THE KLEFFEL FAMILY

Faith Kleffel will be the first to tell you that she has a great jump shot—and that she likes math and reading. Her mom, Julie, wants Faith to be able to live on her own someday, but because Faith is a child with Down Syndrome, Julie knows this will be a challenge for her.

"She requires a tremendous amount of one-on-one customized education in order to be successful because how she learns and how she understands things is very different than normal children," Julie says.

Julie enrolled Faith in a public school when Faith was entering kindergarten, but Faith's needs proved too much for the traditional classroom setting. "What we realized in a hurry was that Faith, although she was able to keep up academically to some extent, she was socially not able to keep up," Julie says.

Julie enrolled Faith in the nation's second education savings account program, which Florida lawmakers enacted in 2014. Called "Personal Learning Scholarship Accounts," Julie uses the funds to pay for Faith's additional services, such as speech therapy, as well as for personal tutors for her academic subjects. Faith was one of the first 1,800 Florida students to use an account in the program's inaugural year.

"I want her to be able to be an independent young lady to the extent that she's capable with my support," Julie says. Personal Learning Scholarship Accounts give Julie and Faith the chance to make this future possible.

> **"In 2012, New Hampshire enacted the Opportunity Scholarship Act, the first tax-credit scholarship program in the country to make homeschooled students eligible."**

CASE STUDY: TAX-CREDIT SCHOLARSHIPS FOR NEW HAMPSHIRE HOMESCHOOLERS

The education savings account programs in both Arizona and Florida are publicly funded, although Florida's ESA is privately managed. New Hampshire offers an example of an educational choice program that is privately funded and managed.

In 2012, New Hampshire enacted the Opportunity Scholarship Act (OSA), the first tax-credit scholarship program in the country to make homeschooled students eligible for scholarships in addition to students attending private school. Under the OSA, businesses receive tax credits worth 85 percent of their contributions to nonprofit scholarship organizations, which provide scholarships for low- and middle-income children to pay tuition at private schools or out-of-district public schools or to cover eligible homeschooling expenses.

However, unlike ESAs in other states, Granite State scholarship students cannot spend part of the funds on tuition and part of the funds on homeschooling expenses. Families must either spend the scholarship funds entirely on tuition or spend them on a variety of educational expenses as homeschoolers. For example, a homeschooling scholarship student could spend part of the funds on tutoring, online courses, or even individual courses at a local district school, but a student attending private school could not spend scholarship funds on tutoring, online courses, or other educational goods and services.

In the first year that the tax credit was offered, the maximum average scholarship value was $2,500 for school tuition or one-fourth that amount ($625) for homeschooling expenses. These caps on the maximum average scholarship sizes automatically increase annually with inflation.

The law also limits the total amount of tax credits available. Businesses could claim up to $3.4 million in the first year and $5.1 million in the second year. In subsequent years, the total tax-credit cap will increase by 25 percent whenever businesses claim at least 80 percent of the total allowed credits. However,

> "New Hampshire provides an example of a privately funded and managed educational choice program."

donors have not yet come close to hitting the cap because of a legislative effort to repeal the tax-credit law and a legal challenge that put the program's future in doubt during the first two years.[21] The only scholarship organization operating at the time, the Network for Educational Opportunity (NEO), raised just shy of $130,000 in the first year and less than half that in the second year. Fortunately, the legislature voted down the attempted repeal and the state supreme court eventually rejected the constitutional challenge. In the third year, NEO and a second scholarship organization, the Going and Giving Alliance, raised a combined $217,000.[22]

Unlike the ESA programs in Arizona and Florida, New Hampshire's TCS law does not specify which categories of educational expenditures are eligible. Rather, it merely prohibits "fees or expenses related to participation in athletic programs, transportation expenses, or the cost of a parent's time expended in the home schooling of his or her child."[23] That gives the scholarship organizations considerable latitude to decide which expenses qualify. Scholarship families primarily buy homeschool curricula, books, educational software, and related materials. However, scholarship organizations have approved some expenses that would not qualify in Arizona or Florida. For example, one low-income family that lacked a computer received permission from NEO to purchase a laptop for educational purposes.[24]

As with Florida's ESA, homeschooling parents in New Hampshire whose TCS applications have been approved must first purchase their desired educational products and services, then submit receipts to the scholarship organization for reimbursement. According to Kate Baker, the president of NEO, the reimbursement model has been "a significant burden" for many families.[25] Since NEO prioritizes based on need, 98 percent of homeschooling scholarship families in the first year of the program had a total household income that would have qualified them for the federal free or reduced-price lunch program (185 percent of the federal poverty line, or $43,568 for a family of four in 2012–13), including 77 percent who would have qualified for a "free lunch" (130 percent of the federal poverty line, or $30,615 for a family of four in 2012–13).[26]

In cases of particular hardship, NEO would make an exception and provide the scholarship funds up front, although Baker was concerned that this was "a high-risk prospect" because if the scholarship recipients failed to return receipts for eligible purchases, the scholarship organization would face consequences from the New Hampshire Department of Revenue. When making an exception, Baker would meet personally with the family and stress the negative impact that failing to submit receipts would have on other families in similarly difficult situations. Fortunately, NEO has had a 100 percent rate of receipt submissions. Baker says that her organization "would be better off with a debit card system," but banks are only willing to set up restricted-use debit card systems when there is a critical mass of users. With only a few hundred scholarship recipients, the costs are prohibitive.

New Hampshire provides an example of a privately funded and managed educational choice program. However, policymakers could go further by breaking down the distinction between private school and homeschool families, thereby giving parents more control over how to spend their scholarship funds. In the next section, we will show how policymakers can combine the models from Arizona, Florida, and New Hampshire to create a tax-credit funded ESA.

TAX-CREDIT FUNDED EDUCATION SAVINGS ACCOUNTS

Education savings accounts funded by charitable contributions that are eligible for tax credits would blend tax-credit scholarships and flexible spending accounts. By combining these educational choice programs, lawmakers could take advantage of the legal and policy advantages of both ideas. Similar to tax-credit scholarship laws, individual and corporate donors would receive tax credits when they con-

A CLOSER LOOK: THE TOTARO FAMILY

Jennifer Totaro, a single mother, had always homeschooled her four boys, ages 17, 14, 11, and 8. The kids enjoy the flexibility that homeschooling gives them to learn in ways that accommodate their unique interests and learning styles. Unfortunately, when Jennifer's income took a hit a few years ago, she wasn't sure how they would manage.

Homeschooling on their limited budget was difficult and time-consuming. "We had to borrow from others, buy used curricula and materials, and spend a lot of time at the library," Jennifer says, "I learned how to really stretch a dollar."

Fortunately, a fellow homeschooler told Jennifer about the Network for Educational Opportunity (NEO), the first scholarship organization to participate in New Hampshire's trailblazing scholarship tax credit program. The Totaros' income qualified and NEO granted scholarships to all the children.

The scholarship program does present one challenge, however. The program requires families to purchase educational goods and services up front, then seek reimbursement. "If you're applying for the scholarship, you probably don't have the money to do that," explains Jennifer. Sometimes she would have to borrow money from her parents or even delay a mortgage payment while waiting for her reimbursement, though she says that NEO was very helpful and accommodating and always reimbursed her within a week or two.

"We're very grateful for the support," says Jennifer. The scholarships allowed the Totaros to upgrade their technology, buy new and unmarked materials, and supplement their homeschooling with a few classes outside the home. The oldest Totaro boy, Michael, is taking some honors-level classes at a nearby community college while his brother Zachary is enrolled in a culinary program at his local high school.

The Totaros believe that homeschooling has equipped them with the knowledge and skills they need to be successful. "Based on their interactions with the public school and college kids, my kids know that they're fully capable and prepared for the next step."

tribute to qualified nonprofit scholarship organizations. These scholarship organizations would then set up, fund, and oversee the education savings accounts for eligible families to use on approved categories of educational products and services.

The scholarship organizations could serve several functions beyond merely collecting donations and issuing ESAs. For example, they could act as information clearinghouses to help families make informed decisions about their children's education. They could also provide an extra layer of accountability by rating education providers or providing ESA families with a platform to do so.

This approach would also increase liberty. Scholarship organizations would have the prerogative to take different approaches to helping families provide a quality education for their children, such as setting standards for educational products or services beyond the letter of the law. Donors would have the freedom to support only those scholarship organizations that they believed were effective and aligned with their values, or to refrain from donating. Unlike government spending, no one would be forced to financially support anything against his or her will.

When crafting tax-credit ESA legislation, policymakers will have to decide among various approaches to designing particular features. This section offers suggestions for policymakers in approaching issues of eligibility, tax credits and funding, spending flexibility, and protection against fraud.

Eligibility

All students of primary and secondary

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> "Even the highest-performing schools might not be the best fit for every child who happens to be assigned there."

school age should be eligible for an education savings account. Arizona and Florida's laws demonstrate that students from different walks of life want—and can benefit from—the flexible learning opportunities that ESAs make available to them.

Most of the existing ESA programs are limited to children with special needs. The accounts serve children with special needs well because often these students benefit from additional services, particularly educational therapies (such as speech therapy and occupational therapy). ESA families frequently combine routine educational environments for children with unique needs, such as a private school or homeschool, with additional therapy services. Students can also use an account to buy assistive services, such as Braille materials in the case of a student with a visual impairment, or audio equipment for a child with an auditory need.[27]

Students with special needs are not the only students who stand to benefit greatly from expanded educational choice. One of the first additional categories of students that Arizona made eligible for ESAs were children assigned to failing district schools. Education savings accounts help these families afford quality private educational alternatives for their children and they can use the accounts to pay for educational tutors to help them catch up to their peers.

However, even the highest-performing schools might not be the best fit for every child who happens to be assigned there. Other students can use the accounts to take college classes prior to high-school graduation, find classes online in technical subjects not offered at local schools, and save money for college tuition. Every child is different, and education savings accounts are flexible enough to help students with diverse interests and needs. Policymakers should consider making all school-aged children eligible to receive an ESA.

Tax Credits and Funding

The law should include tax-credit awards for individual and corporate donations to ESA-granting organizations where possible. As in existing scholarship laws, scholarship- or scholarship-and-education-savings-account granting hybrid organizations would accept charitable contributions, and the state would award tax credits to donors as part of their income tax filings.

Individuals and businesses should receive a 100 percent credit for their contributions to maximize the number of students who will be able to benefit from an ESA. Scholarship organizations in states with dollar-for-dollar tax credit awards, such as Arizona and Florida, have been successful in raising sufficient funds to award tens of thousands of scholarships to students for nearly 20 years.

The scholarship organization should make quarterly deposits into the accounts so that the private entity or department's periodic audits of the accounts can precede future deposits. In this way, fraud or account misuse can be stopped before an account holder conducts repeated abuse.

Prior to the quarterly deposits, the scholarship organization should review participants' expenses over the last quarter. For traditional expenses, such as tuition or personal tutors, the auditors should be able to view the expenses online via a financial provider's (such as a bank's) online management system. As mentioned earlier, in Arizona, families can use education savings accounts at large merchants such as Walmart, and the department of education looks closely at the physical receipts from these retailers to ensure the purchases are in compliance with state law. Auditors should perform the same routine audits to protect taxpayers and make sure families are using the accounts for a child's educational benefit.

Spending Flexibility

The tax-credit ESA law should allow scholarship organizations to award funds to qualifying students that could then be used for multiple products and services. As explained in the "Constitutional Issues" section below, with the exception of New Hampshire, existing tax-credit scholarship laws restrict the use of tax-credit scholarship funds to covering tuition and fees at private schools. However, the most empowering feature of education savings accounts is that they can be used for multiple K–12 or postsecondary needs or saved for future expenses. A tax-credit ESA law should allow private organizations to contract with banks or other firms to award bank accounts with debit cards or specialized online accounts that participants can use for these various expenses.

In Florida and New Hampshire, ESA/scholarship families must purchase educational goods and services with their own money, then file for a reimbursement. Although this method helps to guard against fraudulent purchases, low-income families often cannot afford to pay larger expenses up front. Fortunately, Arizona and Nevada have found ways that provide flexibility for families while guarding against the potential for improper purchases.

In Arizona, families purchase eligible expenditures with restricted-use debit cards. The state agency and participating financial institution share an interface that allows the department to view participants' expenses, confirm audits of physical receipts, and withhold deposits to an account if fraud is uncovered. Nevada is contracting with BenefitWallet, a subsidiary of Xerox that specializes in health savings accounts and other flexible spending accounts, to manage its ESAs.[28] With BenefitWallet, ESA holders can pay for eligible expenses through an app or website. These methods seek to maximize flexibility for families while minimizing the risk of fraud.

Eligible expenses

Lawmakers should include a list of eligible categories of educational expenses in law. Such expenses could include:

- Tuition or fees at a qualified school or an eligible postsecondary institution
- Textbooks
- Educational therapies or services from a licensed or accredited practitioner or provider
- Tutoring or teaching services provided by an individual or facility accredited by a state, regional, or national accrediting organization
- Curricula and related materials
- Tuition or fees for an online learning program
- Fees for a nationally standardized norm-referenced achievement test, an advanced placement examination, or any exams related to college or university admission
- Contributions to a college savings account
- Services provided by a public school, including individual classes and extracurricular programs
- Consumable materials, such as pens and paper
- Computers and tablets
- Any fees for the management of the ESA

State agencies, private scholarship organizations, and parents must have ready access to a list of allowable expenses in order to prevent confusion as parents and students seek to use the debit cards. The state and/or scholarship organizations should make a list of eligible vendors available to participating families and update the list as needed.

Fraud Protection

Although it is impossible for any program, public or private, to completely eliminate fraud, policymakers can take reasonable measures to minimize fraud without unnecessarily burdening ESA families or education providers. Ideally, parents would conveniently access ESA funds through restricted-use debit cards. These cards can be restricted by vendor or by product or service. Restricting the cards by product provides more up-front accountability, but it could reduce spending flexibility for parents. It would also require the state to maintain and frequently update a whitelist of eligible products and services, which could become burdensome. Alternatively, the cards could be restricted to eligible vendors, which

“Every child is different, and education savings accounts are flexible enough to help students with diverse interests and needs.”

> "Scholarship tax credit laws have a perfect record in the courts because . . . tax-credit eligible donations are private funds."

would provide parents with more spending flexibility and be easier to administer. However, in that case, parents should be required to submit receipts for their purchases to ensure the funds are being spent only on eligible products and services.

Fortunately, most participants simply want the best possible education for their children and want to use the program in the correct way. Policymakers must make sure the rules for participating in an education savings account program are clear to all families and students. Clear guidelines will reduce the likelihood that parents will make mistakes. A more detailed treatment of measures policymakers can take to increase transparency and reduce the risk of fraud can be found in Appendix A.

CONSTITUTIONAL ISSUES

Even though the U.S. Supreme Court has affirmed the constitutionality of school choice under the First Amendment in *Zelman v. Simmons-Harris* (2002), legal dangers lurk for many school-choice programs. The most common menaces are the Blaine amendments that exist in roughly three dozen state constitutions.

Blaine amendments vary in their verbiage, but generally they restrict the use of public funds for the support or benefit of sectarian or religious schools. The first such amendments were enacted in the late 19th century, when the public schools functioned as de facto nondenominational Protestant schools. The growing Catholic population created their own schools in part because the religious teachings at public schools differed from their own beliefs; eventually they sought public funding for these schools. Nativists such as U.S. Senator James Blaine of Maine objected and fought for an amendment to the U.S. Constitution that would prohibit publicly funding "sectarian" (i.e., Catholic) schools.[29] Although the proposed federal amendment failed, most states adopted some form of the so-called Blaine amendment in their state constitutions.

State courts have interpreted their Blaine amendments in various ways. The state supreme courts in Indiana and Wisconsin held that school-voucher laws were constitutional despite the presence of Blaine amendments in their state constitutions, but state supreme courts in Arizona and Colorado have invalidated school vouchers under their Blaine amendments.[30] By contrast, no state supreme court in any of the 16 states with scholarship tax credit laws has ever found them to violate a Blaine amendment. Education savings accounts were upheld in Arizona against their only Blaine-amendment challenge to be decided so far. Legal challenges to ESAs are pending in Florida and Nevada.

Scholarship tax credit laws have a perfect record in the courts because Blaine amendments generally apply only to "appropriations" of public funds, whereas tax-credit eligible donations are private funds. In *Kotterman v. Killian* (1999), the Arizona Supreme Court held that tax credits are not appropriations because "no money ever enters the state's control as a result of [the] tax credit." Rather, tax credits simply leave money in the hands of taxpayers who are free to choose which scholarship organizations to support with their own money.[31] More than a decade later, the U.S. Supreme Court rejected the standing of petitioners challenging Arizona's scholarship tax credit law on similar grounds, holding that private funds do not become public funds until they "come into the tax collector's hands." Rather, when "taxpayers choose to contribute to [scholarship organizations], they spend their own money, not money the State has collected."[32] The New Hampshire Supreme Court likewise rejected the standing of petitioners challenging the state's scholarship tax credit law, ruling that they could not demonstrate any harm.[33] The following year, citing the decisions in Arizona and New Hampshire, the Alabama Supreme Court also held that a "tax credit to a parent or a corporation . . . cannot be construed as an 'appropriation'" but rather such funds retain their status as private funds until they enter the public treasury.[34] That view seems to be the prevailing one in courts, so with the possible exception of Michigan, where the state constitution explicitly prohibits tax benefits for religious education, tax credits should survive scrutiny under such provisions. By contrast, both vouchers and education savings accounts do involve appropriations.

Courts often construe Blaine amendments to prohibit only direct aid to religious schools. Here the types of school-choice programs represent a sliding scale. In *Zelman*, the U.S. Supreme Court ruled under the First Amendment that vouchers are not direct aid because individual parents decide where the money will be spent. In *Cain v. Horne*, the Arizona Supreme Court struck down vouchers under the Blaine amendment because recipients could only use the vouchers at private schools, most of which were religiously affiliated. By contrast, education savings accounts subsequently were upheld in Arizona (*Niehaus v. Huppenthal*, 2013) because they can be used for a wide variety of educational purposes. In this regard, tax-credit scholarships (outside New Hampshire) are more like vouchers to the extent they can only be used for private schools.

It is impossible to predict with any certainty how a particular court will rule on a contentious issue, but policymakers can design laws in ways that increase their likelihood of withstanding constitutional scrutiny. If a Blaine amendment presents a potentially serious obstacle in a particular state, lawmakers could put education savings accounts on more solid constitutional grounds by funding them through tax credits rather than through legislative appropriations. In that way, their proposal combines the two features that have proven most resistant to Blaine-amendment challenges: it is neither an appropriation of public funds nor a form of aid limited only to private or religious schools.

CONCLUSION

Education savings accounts empower families to customize their children's education. Since every child is different, these accounts allow families to find learning experiences for their children that are as unique as each child. They are an improvement on traditional school-choice programs because they enhance the freedom of parents to purchase a wide variety of educational products and services and save for educational expenses in future years, including college.

Previous ESA laws have been funded through state treasuries, but policymakers could increase freedom for taxpayers by funding ESAs through voluntary donations to nonprofit scholarship organizations for which donors would receive tax credits. Sixteen states already grant tax credits for scholarships for private schools, and New Hampshire's law allows families to use the scholarships in a manner similar to ESAs. Moreover, Florida's ESA program is run by the state's largest tax-credit scholarship organization, providing a model for the private management of an ESA program. In states where courts have narrowly interpreted their state constitution's Blaine amendment, funding ESAs through tax credits is a constitutionally sound method of providing every child with the chance at an excellent education.

APPENDIX A: TRANSPARENCY AND ACCOUNTABILITY

Education Savings Account Transparency

No assistance program—public or private—is immune to financial fraud. Fraud in public school districts is well documented state-to-state, and Arizona's education savings accounts are not immune to financial misuse. However, the accounts have two characteristics that protect taxpayers and participating students from exceptional mismanagement: merchant category codes and regular audits.[35]

1. **Merchant Category Codes.** Education savings account cards function much like credit or debit cards. In order to use a savings account card at a retailer or other vendor, that vendor's merchant category code must be allowed for use by the state department of education.

"Education savings accounts empower families to customize their children's education."

A student could swipe their card at a tutoring center, such as Sylvan Learning Center, for example, and because the tutoring office's credit card machine is categorized as an educational expense, the education savings account card would be accepted as a form of payment.

If a parent or student tried to use the card at a gas station or to buy airplane tickets, the merchant's credit card payment system would be categorized under a different classification—a noneducational category. As such, the education savings account card would reject the purchase. The transaction would not be completed.

2. **Quarterly and Annual Audits.** The Arizona Department of Education conducts quarterly and annual audits on the accounts. The department makes quarterly deposits into the accounts, and every account is audited prior to the deposits. Parents must submit paper receipts for all of their account purchases, and the department can view all account transactions online.

   If the agency detects fraud, the department will contact the participant to resolve the question about an expense or suspend an account until the expense is either rejected or confirmed. This procedure has the effect of preventing large-scale fraud or financial misuse.

   Many account expenses, such as private school tuition and educational therapy services, are simple and require little scrutiny. Yet since participants can use an account at certain large retailers such as Walmart, the department and state treasurer must review these purchase carefully to make sure families are making purchases that are allowable under state law.

In Florida, Step Up for Students takes similar steps to prevent fraud. When a family applies for a Personal Learning Scholarship Account, Step Up checks with the state's voucher program, the McKay Scholarship Program, and the organization's own records for students using a tax-credit scholarship to see if an applicant is already participating in one of these options. If so, the application will be denied because students cannot use multiple scholarship programs at the same time.[36]

As explained earlier, once a student has been awarded an account, parents and students submit proposed expenses to Step Up prior to making a purchase using an online system. Once Step Up has reviewed and approved the expense, parents make the purchase and Step Up reimburses the family using the student's account funds.

The reimbursement procedure prevents families from being reimbursed for unauthorized expenses and misusing taxpayer money. Step Up for Students lists the reimbursement procedure's steps and outlines eligible expenses in a parent handbook the organization created to help participating families. Arizona's department of education also created a handbook for students and families.[37]

APPENDIX B: RESOURCES

For more information about education savings accounts, we suggest consulting the following reports and essays:

Ladner, Matthew. "The Way of the Future." Friedman Foundation for Educational Choice, September 27, 2012, http://www.edchoice.org/research/the-way-of-the-future/.

A report describing the economic theory behind education savings accounts and discussing Arizona's Empowerment Scholarship Account program.

Butcher, Jonathan. "Education Savings Accounts: A Path to Give All Children an Effective Education and Prepare Them for Life." Goldwater Institute Policy Report no. 253, October 30, 2012, https://goldwater-media.s3.amazonaws.com/cms_page_media/2015/2/2/PR253ESAsPathToAllChildren_0.pdf.

A report describing how to design and implement an Arizona-style ESA program.

Butcher, Jonathan, and Jason Bedrick. "Schooling Satisfaction." Friedman Foundation for Educational Choice, October 10, 2013, http://www.edchoice.org/research/schooling-satisfaction/.

The first survey of families participating in Arizona's ESA program. Whereas fewer than half of survey respondents were satisfied with their previous district school, 100 percent were satisfied with the ESA program, including 71 percent that reported being "very satisfied."

Burke, Lindsey. "The Education Debit Card." Friedman Foundation for Educational Choice, August 28, 2013, http://www.edchoice.org/research/the-education-debit-card/.

A report examining how Arizona families used their ESAs in the first year of the program, when eligibility was limited to students with special needs. Nearly two-thirds of families spent all of their ESA funds on private school tuition, while slightly more than one-third spent the funds on multiple educational goods and services.

Burke, Lindsey, and Jonathan Butcher. "The Education Debit Card II." Friedman Foundation for Educational Choice, forthcoming (title tentative), http://www.edchoice.org/research/the-education-debit-card-ii/.

A follow-up to the above report, examining how Arizona families are using their children's ESAs after eligibility had been expanded to include several categories of students. About 70 percent of families spent all of their ESA funds on private school tuition, while nearly 30 percent spent the funds on multiple educational goods and services.

Bedrick, Jason, and Lindsey M. Burke. "The Next Step in School Choice." *National Affairs* 22 (Winter 2015), http://www.nationalaffairs.com/publications/detail/the-next-step-in-school-choice.

An essay describing the advantages of ESAs and exploring multiple design options. By empowering families to spend funds on a variety of educational products and services or to save for future educational expenses, ESAs incentivize users to maximize both value and efficiency and foster an unbundling of educational services. Florida's privately managed ESA program appears to have several advantages over Arizona's publicly managed ESA, including stronger incentives and greater flexibility to meet the needs of families.

Butcher, Jonathan, and Lindsey Burke. "Expanding Education Choices: From Vouchers and Tax Credits to Savings Accounts." Heritage Foundation, Special Report no. 136 on Education, July 26, 2013, http://www.heritage.org/research/reports/2013/07/expanding-education-choices-from-vouchers-and-tax-credits-to-savings-accounts.

A report explaining how policymakers can transform existing tax-credit scholarship and voucher programs into ESAs.

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to Families," *New York Times*, March 27, 2013, http://www.nytimes.com/2013/03/28/education/states-shifting-aid-for-schools-to-the-families.html.

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