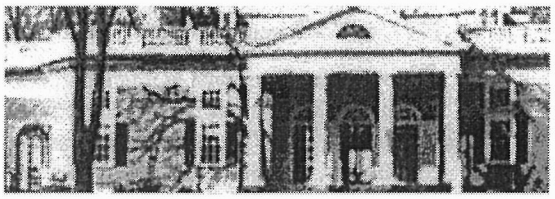

THE THOMAS JEFFERSON
INSTITUTE FOR PUBLIC POLICY

Better Education for *All* Children:
A Fiscal Analysis of
A Virginia Educational Improvement Tax Credit

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January 2006

verizon

Thomas Jefferson Institute for Public Policy

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The work of the Thomas Jefferson Institute for Public Policy is geared toward educating our political, business and community leadership about the issues facing our society here in Virginia. The Institute offers suggested solutions to these problems in a non-partisan manner.

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Better Education for *All* Children

Foreword

School choice already exists in America – unless you are poor.

Affluent families have choice because they can move to different neighborhoods or communities, send their children to private schools or supplement education with tutors and enrichment programs. Lower-income and working-class families, meanwhile, are typically trapped with one option by virtue of their zip code – and most often that is a school in need of improvement.

This update of a 2005 paper by Chris Braunlich of the Thomas Jefferson Institute for Public Policy outlines one cost-effective solution to the challenge of increasing educational opportunity for all Virginians. It proposes setting up an educational tax credit that could then be used by sponsoring non-profit groups to provide scholarships to students without alternatives.

Most importantly, this paper demonstrates why such a tax credit would not hurt the state's treasury … and not be a drain on local school districts. It would, in fact, generally leave more money available for education at the local level throughout Virginia while still providing school choice for parents who currently do not have it.

This is not a radical idea.

Parents in a growing number of cities and states have access to public programs supporting school choice. In the most recently-available numbers, more than 100,000 students in Maine, Vermont, Florida, Ohio, Wisconsin and Washington, DC use publicly-financed school choice to find the best options for their children. Another 540,000 families in Illinois, Minnesota and Iowa use personal tax credits or deductions to make educational alternatives more affordable. And last year, for the first time, the Virginia House of Delegates approved similar scholarships for low-income students here in Virginia.

Demand for such scholarships far outstrips supply: In April 1999, parents submitted more than 1.25 million applications for the 40,000 scholarships awarded by the Children's Scholarship Fund. Nothing has happened since to lessen the demand.

Parents are demanding better for their children – not because they are "anti-public schools," but because they want quality schools, both public and private, for their children. They understand that our children are our most precious resource, and it is our responsibility to love them, nurture them, protect them, and ensure that they are properly educated.

Without a good education, the next generation has no real chance to engage in the practice of freedom: the process of transforming their, or our, world. We owe it to them to provide the best we've got … and the Virginia Educational Improvement Act is an important path to the best.

Robert Ashford
Chairman/President,
Virginia Black Alliance for Educational Options
January 2006

Better Education for *All* Children
A Virginia Educational Improvement Tax Credit
Executive Summary

In the debate over parental choice in Virginia, many questions remain unanswered.

What would be the fiscal effects of a parental choice package, both at the state and local level? Where else in the United States has parental choice been used, and what forms has it taken? What would be the best path to choice in Virginia?

What are the unique obstacles to parental choice in Virginia, and what historical challenges have made choice an emotional issue among many black Virginians? What has been the academic impact of parental choice in other states – both for the students who choose to leave the public schools and for those who choose to remain in public schools?

In January 2005, the Thomas Jefferson Institute reviewed these issues, offering answers and proposing a means by which parental choice might successfully help at-risk students in the Old Dominion. This paper updates last year's study with new information.

In the section *The View From Other States*, we briefly review the differences between vouchers and tax credits explaining why a tax credit system is preferable in Virginia. We then explore the tax credit systems existing in six other states.

Historical Perspectives in the Old Dominion examines how tuition grants were used a half-century ago to block integration in Virginia. We also underscore the differences between the race-based choice of the '50s and '60s, and contrast it with the freedom-based choice used to assist at-risk, mostly minority, children around the country today.

In *Help for Students*, we explore the impact of more than a half-dozen parental choice programs, reviewing studies demonstrating positive effects on public and private schoolchildren.

Finally, in *A Virginia Educational Improvement Tax Credit Proposal* we suggest a prototype tax credit and outline the impact such a proposal would have on a per-pupil basis. Because the composition of per-pupil funding varies so greatly in Virginia from school division to school division, we demonstrate the impact on both state and local expenditures.

Our conclusions: An Educational Improvement Tax Credit program would work best in Virginia, avoiding legal obstacles inherent in a voucher system. A Virginia program should focus on high poverty students, not only because these are the students most in need of alternatives, but because such a focus would eliminate concerns about the "re-segregation of Virginia's schools." While the results are not uniform, where parental choice has been utilized it has had a positive effect on the academic performance of students who exercise choice as well as improving the education of children who remain in the public schools.

And finally, we conclude that an Educational Improvement Tax Credit as we outline would have no effect on state funding of education. The effect on local school system finances would generally have a positive impact on available funds at the local level.

The Thomas Jefferson Institute for Public Policy is appreciative of the support from Verizon Corporation in Virginia, which enabled us to research, publish and distribute this study.

The View from Other States

Forms of parental choice exist in all or portions of eleven states. These include state-funded voucher programs for high poverty students, long-time tuitioning programs in Vermont and Maine (where, for nearly 150 years, public money has been used to send students to private schools), and tuition tax credit plans offering tax credits for parents or companies to underwrite further options for students.

However, a generalized voucher plan – whereby the state offers a direct voucher to parents for use in the school of their choice – is less likely to be successful in Virginia because of the state's status as a "Blaine Amendment" state.

In 1875, Congressman James G. Blaine (R-ME) authored an amendment to the U.S. Constitution prohibiting the use of public money at "sectarian" schools. Although narrowly defeated in the U.S. Senate, individual states began passing similar amendments into their state constitutions as a direct result of the Nativist, anti-Catholic bigotry that ran strong through American politics in the late 1800s and early 1900s. Thirty-six states and the Commonwealth of Puerto Rico currently have such language.

The Virginia State Constitution contains such prohibitive language. Although the federal constitutionality of the "Blaine Amendment" is likely to be challenged, such a challenge will take time working its way through the federal court system to the U.S. Supreme Court.

In addition, Virginia's Constitution includes "compelled support" provisions dating back to the colonial era with the intention of preventing state government from compelling individuals to financially support or attend a church designated by the state.

The existence of the "Blaine Amendment" and "compelled support" language in the Virginia Constitution makes passage of a voucher plan less likely. Vouchers are also considered suspect by many parental choice supporters, fearing they will lead to increasing state and/or federal involvement and mandates in school curricula and instructional methodology.

As a consequence, the likely path to parental choice in Virginia is the use of tax credits. A tax credit or deduction does not involve the use of funds already collected by the state, and instead offers a tax benefit directly to the individual or corporation offering educational funding. Five states – Arizona, Florida, Illinois, Minnesota and Pennsylvania – offer some form of tax deduction or credit. A brief description of those programs is important to provide background for any discussion regarding Virginia's options.

Arizona:

Under the Arizona plan, all students are eligible to receive scholarships from approved Student Tuitioning Organizations (STOs). The number of students served is limited only by the amount of funding that flows into the program. Begun in 1998, individual taxpayer donors to STOs may claim a dollar-for-dollar refund up to $500; married couples may claim up to $825. In 2006, married couples will be able to receive up to $1,000 in tax credits. An additional $250 may be claimed for contributing to a public school foundation.

The individual STOs define which students are eligible (within certain non-discrimination guidelines), and also decide the amount of support to each student. The level of aid is typically between half and 80 percent of private school tuition. There is no income cap for recipients, and individual taxpayers may not make a contribution to an STO for his/her/their own child. In school year 2004-05, 21,160 students received scholarships.

Arizona's law requires STOs to provide the state with data including the total number and amount of contributions received, number and names of children awarded scholarships and the dollar amount of those scholarships.

Florida:

Florida has had the most robust number of parental choice options, including state-funded "Opportunity Scholarship" vouchers for children in failing schools (A+ program) and for Special Education students (McKay Scholarships), as well as a choice program for pre-school youngsters.

However, a January 5, 2005 Florida Supreme Court decision struck down the Opportunity Scholarship program under a provision of the Florida state constitution requiring that state to provide "a uniform, efficient, safe, secure, and high quality system of free public schools." The Florida court held that the provision limits such opportunities to public schools only. Similar challenges in Wisconsin and Ohio were rejected, and the Florida ruling affects Florida programs only: Virginia does not have a similar "uniformity" clause in its state constitution.

In addition, the Court specifically limited the impact of its decision to Opportunity Scholarships only, leaving the state's corporate income tax credit scholarship program untouched – and it is precisely that program which is most similar to the provisions suggested in this paper.

The Florida Corporate Income Tax Credit Scholarship Program began operation in 2002. In return for donating to Scholarship Funding Organizations (SFOs), corporations may receive a dollar-for-dollar tax credit off their corporate income tax. SFOs provide scholarships of up to $3,500 for low-income students to attend the private or religious school of their choice. A transportation scholarship is valued at up to $500.

Corporations may donate up to 75 percent of the tax they owe. However, contributions are capped at $5 million to any single SFO. The state-wide cap on total corporate contributions is $88 million. Approximately 15,000 children are expected to use these scholarships in 2005-06, or less than one percent of eligible Florida students.

Scholarship Funding Organizations must be a recognized non-profit granting scholarships to low-income students; must register with and be approved by the Florida Department of Education; disburse 100% of funds for scholarships and conduct an annual outside audit.

Private and religious schools participating in the program must complete a 40-question form, including questions ranging from the number of teachers to food safety inspections.

Illinois:

The Illinois tuition tax credit program, which began operating in 2000, provides an individual 25 percent tax credit for expenditures above $250, up to a maximum of $500 per family, for approved education expenses at any private or public school. These expenses may include tuition, books and lab fees. The credit cannot reduce an individual's tax burden to less than zero.

All students are eligible to benefit when their parents invest in eligible education expenses, provided that the taxpaying parent has proof of expenses. Over 185,000 taxpayers took the credit in 2003, and slightly more than eight percent of eligible students participate.

Iowa:

Iowa offers families a personal tax credit, refunding 25 percent of educational expenses up to a maximum refund of $250. These expenses may include tuition and textbook expenses for subjects commonly taught in public schools, as well as extracurricular activities such as athletics, music, or driver's education. Expenses in connection with religious teachings or worship, through programs in for-profit schools, or for schools not complying with civil rights laws are excluded. More than 101,000 families participate, benefiting nearly 20 percent of Iowa students.

Minnesota:

Minnesota offers both a tax credit (begun in 1997) and a tax deduction (in 1995), depending upon the income level of the taxpayer. All students are eligible, and the tax benefit may be taken when the taxpayer invests in approved education expenses for a child, including books, tutors licensed by the state, and academic after-school programs. Those eligible for the tax deduction may also deduct tuition fees at private schools.

Taxpayers earning less than $37,500 per year may claim a tax credit of 75 percent for their non-tuition education expenses, up to a $1,000 credit for each child. This credit begins to phase out for taxpayers earning above $33,500, at which point the maximum credit is reduced one dollar for every four dollars of earned income. Above $37,500, families with more than two children may add $2,000 to the income ceiling for each child in the family after the first two. Some 60,000 families claim the credit, and 10.5 percent of eligible students participate.

Taxpayers not eligible for a tax credit may receive a 100 percent tax deduction of up to $1,625 per child in grades K-6 and $2,500 for a child in grades 7-12. It is estimated that 186,000 families take some part of the tax deduction, for nearly 20 percent of all Minnesota students.

Pennsylvania:

The Pennsylvania Educational Improvement Tax Credit (EITC) program began operation in 2001. The program provides corporations a tax credit of 90 cents on the dollar for two years of contributions to Scholarship Organizations (SOs) offering scholarships for eligible children to attend public, private or religious schools; or for contributions to Educational Improvement Organizations (EIOs) that support innovative programs in public schools. Single year donations receive a 75 percent tax credit.

The tax credit is capped at 75 percent of a corporate tax obligation, up to $200,000 (or 90 percent if they make a two-year contribution commitment). In total, the program is capped at $29.3 million for scholarships each year and $14.7 million for educational improvements. Credits are offered on a first-come, first-served basis, as determined by the state, until the annual cap is met. Last year, there was a waiting list of 213 companies wanting to make a donation to an EIO and 298 companies wanting to make a donation to an STO

Eligible students are defined as those in families with an income $50,000 or less per family. Allowances are made for each additional child, and household income excludes non-salary income such as disability, workers or unemployment compensation, public assistance, etc.

During the 2004-05 school year, about 25,000 students received scholarships, or about 1.2 percent of eligible students. Since 2001, more than 2200 companies have donated more than of $127 million: $84 million for SOs and $43 million for EIOs. Fifty-seven percent of participating companies have given less than $10,000.

Pre-Kindergarten Programs:

Within the last two years Pennsylvania has enacted a tax credit program for students to attend pre-kindergarten classes. In light of Governor Tim Kaine's proposal for a "Universal Pre-K" program in Virginia, it is worthwhile to comment on that program, as a consideration for the General Assembly's actions in 2006.

Pennsylvania began operating its pre-Kindergarten Tax Credit (PKTC) program in 2004 as an expansion of the state's Educational Improvement Tax Credit Program. The program gives tax credits to businesses making contributions to pre-k Scholarship Organizations, approved by the Commonwealth of Pennsylvania, that offer scholarships to eligible 3-and 4-year-olds for public, private or religious pre-kindergarten programs. Total tax credits are capped at $5 million annually, and each business may receive a 100 percent credit on their first $10,000 donation and up to 90 percent on its remaining contribution up to $100,000. Families of eligible students must earn less than $50,000 per year, with a $10,000 allowance for each dependent.

Historical Perspectives in the Old Dominion

Virginia, like other southern states that resisted court-ordered desegregation efforts, faces particular challenges inherent in any choice-based education proposal.

These challenges stem from memories of race-based tuition grants enacted by the General Assembly and used by white Virginia officials to deny black students a K-12 education. The story of those actions is instructive in understanding the emotional opposition of many black Virginia leaders to school choice, and also important in underscoring the differences between the 1950/60's-era choice programs and those advocated in the 21st century.

Opposition to *Brown v. Board of Education* was led by Virginia's elected leaders, most notably U.S. Senator Harry Byrd (D-VA). Byrd persuaded 101 of 128 southern congressmen to sign the "Southern Manifesto," arguing that the Supreme Court's decision in *Brown* was contrary to established principles of federal law. [1]

Virginia was also among the first to enact a state version of the "Southern Manifesto" and in 1956 approved a tuition grant statute designed to circumvent the Court's decision in *Brown*.[2] Tuition grants were originally restricted to private schools and used by white parents to send their children to all-white private academies after local officials attempted to close the public schools, rather than desegregate. Following court decisions prohibiting such public school closures, the General Assembly made the tuition grants available for use at public schools in neighboring school divisions, as well.[3]

While most local school systems complied with court decisions, Prince Edward County did not. Instead, the county closed all public schools to both white and black students from 1959 to 1964. The tuition grant was then utilized at white-only private academies opened during those five years.[4]

The only other alternative for the formal education of black children was to send them to another county. While a handful of white children did not enroll in the academies, more than two-thirds of black children were denied any formal education during this time. Those that received formal education usually did so only by sneaking over county borders to other school systems or by being sent out of the county to live with relatives.

The U.S. Supreme Court intervened in 1964 in *Griffin v. County School Board of Prince Edward County*, ruling that closing public schools and providing public funds for the all-white academies violated the equal protection clause of the U.S. Constitution.[5] The tuition grant law by itself was left unscathed. Not until 1969 did a federal district court in *Griffin v. State Board of Education* rule that Virginia's tuition grant law violated the equal protection clause because of its racist use to circumvent *Brown.*[6]

This 13-year battle for the education of their children is seared into the souls of black Virginians who understandably oppose any hint of reviving a mechanism that sounds suspiciously similar. During the 1950/60s private schools became, indeed, an all-white alternative for those seeking to circumvent integration, and the voucher programs of that period constituted state financing of racial discrimination.

But there are clear differences between the race-based choice movement of the '50s and '60s and the freedom-based school choice movement of the 21st century, and these differences need to be understood.

Primary among these differences is intent: During the 13-year history of tuition grants in Virginia, federal courts repeatedly determined that they violated the federal equal protection clause. Over the 14 years that the Milwaukee voucher program has been in place, for example, such a determination has never once been made.[7]

Race-based school choice plans were developed specifically to prevent integration and maintain segregation. Indeed, eligibility for the '50's/'60s era tuition grant was triggered only by a school closing and only students who had been in a public school were eligible. Virginia Code *required* closing any public school that became integrated either through court order or voluntary action. In fact, the Governor was authorized to assign a student to another public school when "mixing of White and Colored children constitutes a clear and present danger."[8]

Current freedom-based school choice plans are not predicated upon the closing of a public school and race has no criteria in determining eligibility. In states where school choice has been provided, parents of all colors and backgrounds are able to enroll their children into any school they wish.

More importantly, the old '50s-era grant program was enacted before the Civil Rights Act of 1964. Race-based criteria would specifically be prohibited today. Every current school choice program prohibits private schools from discrimination contrary to the guidelines of the Civil Rights Act of 1964.

The programs put in place throughout the country – whether voucher programs in Cleveland, Milwaukee and Florida or tuition tax credits in Arizona, Pennsylvania and Florida – contain strong anti-discrimination language. While the concerns of black Virginians are understandable, knowing the history in the Old Dominion, those concerns will not become reality because of federal law and the vigilance and motivations of those fostering school choice in the 21st century.

Help for Students

The bottom line in any education debate should be the effect on students. Often lost in the debate over school choice are answers to three simple questions: Does it help students? Does it provide positive opportunities for students who leave the public school system? And what is the impact on those students who choose to remain within the public school system?

Here's what the research shows –

In ***Cleveland, Ohio,*** families with incomes below 200% of the federal poverty level are given priority for vouchers valued at up to the lower of $2,700 or the cost of private school tuition (families with higher incomes are eligible only if state funds are available). Between the fall of 1996 and the spring of 1998, a Harvard University study found that children using vouchers to attend the two "Hope Charter Schools" experienced a seven percentile point increase in reading and a 15 percentile point increase in math.[9] The most recent report conducted by the Indiana University Center for Evaluation found "there is some evidence of a pattern of slightly greater annual achievement growth among students who have used a scholarship continuously since kindergarten."[10]

In ***Florida,*** the A+ Opportunity Scholarship Program of $4,537 for students in grades K-3 and $3,370 for children in grades 4-8 is available to any student attending a public school that is given an "F" grade for two years in any four-year period.[11] In existence since 1999, a 2001 state-sponsored study found that schools most at risk of being "voucherized" (in other words, about to have vouchers offered to their students) "achieved test scores gains more than twice as large as those achieved by other schools." A 2003 study demonstrated that low-performing schools "already facing competition from vouchers showed the greatest improvements … improving by 9.3 scale score points on the FCAT (Florida Comprehensive Assessment Test) math test, 10.1 points on the FCAT reading test, and 5.1 percentile points on the SAT-9 math test."[12] The threat of having vouchers offered to their students helped spur at-risk schools and school districts to take effective action ensuring greater educational achievement for students in the public schools.

A study by Washington reporter Carol Innerst found that the threat of vouchers drove Florida's lowest-performing schools to enact innovative programs, such as an extended school year, increased reading specialists, one-on-one tutoring programs and greater use of phonics.[13]

And a 2005 paper by Harvard Professors Martin West and Paul Peterson concluded that the Florida A+ Opportunity Scholarship program has a greater positive impact on student performance – particularly for black students, students eligible for free and reduced meals, and those with the lowest initial test scores – than the federal No Child Left Behind Act.[14]

Also in ***Florida,*** the McKay Scholarship program offers vouchers to students with disabilities whose parents are unhappy with their assigned public school. The voucher is equal to the lesser of either the amount of funding a student would have generated at the public school or the cost of the private school's tuition and fees. Now serving more than 16,000 students, a 2003 Manhattan Institute study found that class size dropped dramatically for these students, from an average of 25.1 students per class in public schools to 12.8 students per class in "McKay Schools."[15]

In addition, McKay schools outperformed public schools on measures of accountability for services provided. Almost three times the number of participants (86 percent) in McKay schools report receiving all the services required under federal law vs. those in public schools (30.2 percent).[16]

In ***Maine,*** where vouchers have been in existence since 1873 and are used by more than 11,000 students, a study by Dr. Christopher Hammons, of Houston Baptist University in Houston, Texas found that – even when taking into account per-pupil spending, poverty and other factors – standardized test scores increase as competition among high schools for tuition dollars increase. To purchase the same gain in test scores achieved by competition, by increasing per-pupil spending, would cost an additional $909 per pupil. These same conclusions were also drawn by Dr. Hammons in his study on ***Vermont*** schools, which have had a voucher program since 1869.[17]

In ***Milwaukee, Wisconsin,*** students whose family income does not exceed 175 percent of the federal poverty level are eligible to receive a voucher worth up to $5,783 or the cost of the private school – whichever is lower. There have been seven state-sponsored evaluations of the program, and three additional studies conducted by researchers from Harvard and Princeton. State studies sponsored by University of Wisconsin Professor John Witte did not find test score gains but noted, "Choice can be a useful tool to aid families and educators in inner city and poor communities."[18] Harvard researchers found that students in the program for four years achieve a gain of 11 percentile points in math and six percentile points in reading.[19] Princeton researchers found that students in the program for four years achieve a gain of eight percentile on the math portion of the Iowa Test of Basic Skills.[20] Harvard Professor Caroline Hoxby concluded that performance improved faster at public schools where many students could receive vouchers, noting that "public schools most exposed to competition increased math scores 7.1 percentile points between 1999 and 2002."[21]

The Milwaukee choice program has also driven other improvements. Between 1990 and 2001, the drop-out rate in public schools declined by 37 percent, real spending per-pupil increased by nearly 35 percent, and test scores increased in 12 of 15 categories. Part of these improvements resulted from reforms instigated by school choice: Teaching vacancies filled without regard to seniority; education dollars "strapped to the backs" of students, following them to the schools they chose; and individual schools controlling 95 percent of their operating budget.[22]

Finally, a September 2004 Manhattan Institute study demonstrated that choice students in Milwaukee graduate high school at much higher rates (64 percent) than students in traditional public schools (36 percent). More importantly, those graduation rates are higher than those at selective public high schools (41 percent) where students are more likely to have an advantaged background.[23]

Privately-sponsored scholarships are in existence throughout the United States, and are more heavily concentrated where a tax *credit* (as opposed to tax *deduction*) exists. Where they are heavily concentrated, their results have been similar. In New York City, a Harvard University study found that, after three years, black students with privately funded vouchers scored 9.2 National Percentile Rank (NPR) points higher than their public school peers on Iowa Test of Basic Skills composite tests.[24] In Dayton, Ohio, researchers found that after two years black students had a gain of 6.5 percentile points on standardized tests.[25] In Charlotte, North

Carolina, students receiving a privately-funded voucher achieved a 5.9 percentile point gain in math and a 6.5 percentile point gain in reading after one year.[26]

In Edgewood, Texas, where schoolchildren were offered a scholarship to the school of their choice, the privately funded voucher program helped the high-poverty district outperform 85 percent of Texas school districts in achievement gains.[27]

Not all reports are necessarily quantitative. In ***Washington, DC***, the Opportunity Scholarship Program offering parents federal vouchers to place their children in private schools was analyzed by Georgetown University researchers Patrick Wolf, Thomas Stewart and Stephen Cornman. The report determined that "higher academic standards, improved safety, increased discipline, greater parental involvement and access to a religious and values-based environment were among the top reasons why parents express satisfaction" with the school choice program. While the program is too young to determine academic differences, the fact that children were safer when attending something other than the crime-ridden traditional DC public school system is an important consideration for their future.[28]

While parental choice remains a sufficiently limited option to prevent any uniform conclusions, it is clear that where choice has been offered, both students who exercise the option to choose another school and those who choose to remain in their traditional public schools have benefited.

A Virginia Educational Improvement Tax Credit Proposal

Opponents of school choice consistently argue that giving poor students the right to choose a better school would "use public money for private schools" and would "hurt public schools by cutting their funding."

Any successful school choice proposal must necessarily rebut these concerns and must also address the fears of those who believe such a choice proposal would "re-segregate Virginia's schools." Over the last several years, numerous choice proposals have been introduced in the General Assembly but not until last year, when the House of Delegates approved HB 1942, sponsored by Delegate Chris Saxman, had any choice legislation made significant progress.

The structure proposed in this paper seeks to continue "moving the ball forward" on the school choice issue while simultaneously rebutting the frightening and false claims made by choice opponents. This proposal consolidates a number of ideas and is largely based on the successful corporate tax credit used in Pennsylvania as well as HB1942.

This paper does not comment upon, or attempt to analyze any components providing tax credit assistance to upper income parents. Our analysis is aimed solely at the issue of expanding educational opportunities to students who heretofore have had none. Such an expansion should include the following components –

- It should offer a tax credit to companies for donations to a Scholarship Organization providing scholarships for eligible children to attend the school of their choice. The scholarships must be large enough to make a difference in a family's ability to choose a school. The tax credit should be large enough to offer encouragement to the donor to take action while not so large as to damage the state treasury. Given Virginia's relatively low tax rate, a tax *deduction* provides only minimal tax benefits, so a larger tax *credit* is needed to maximize the incentive for participation. For the purposes of this proposal, we propose a scholarship equal to the level of state funding for each student in the school division in which he or she resides and a 90 percent tax credit for corporate donations to Scholarship Organizations.

  A tax credit also avoids such obstacles as Virginia's Blaine Amendment, as well as conservative opposition to private school acceptance of state funds and the likely mandates and requirements that could accompany such funds.

- It should target its resources towards those most in need, and those least able to exercise school choice. For the purpose of this proposal and for an easily-defined benchmark, we suggest defining eligible students as those who are currently enrolled in a public school and are eligible for "Free or Reduced Meals" in public schools. This means a student from a family at or below 185% of poverty level (or nearly $36,000 for a family of four) could receive such scholarships. In school year 2004-2005, about 387,000 Virginia students – or 33.48 percent of all students – would have been eligible to receive scholarships.[29]

  While such a limitation will be offensive to some school choice purists, it ensures that a Virginia choice proposal will not lead to the "re-segregation of Virginia schools." Furthermore, by targeting high poverty students, the proposal also targets the population

educators say is among the hardest to educate, eliminating the argument that school choice will "cream" the best student away from public schools.

- The total state-wide tax credits should be capped, at least in the early years. Both Florida and Pennsylvania did so, although Pennsylvania recently raised its cap to accommodate demand. We suggest a cap of $30 million – about the same as Pennsylvania's state-wide cap of $29.3 million and far below that of Florida ($88 million). Typically, state economic fiscal analysts will score this as a $30 million "loss" to the treasury. However, as we shall see, this proposal results in neither a "loss" nor a "gain" to the state treasury.

  Most choice proposals are capped in the early years in order to manage both demand and capacity. Although, as we shall see, an Educational Improvement Tax Credit does not "drain the treasury," placing a cap on the total amount of the tax credit will lance the inevitable "cost" argument until fiscal experience makes the point moot.

- An Educational Improvement Tax Credit proposal must ensure that both the funding organizations and the non-public schools are legitimate. In the case of the funding organizations, they must be a charitable 501(c)(3) organization authorized to provide scholarships, may retain no more than 10 percent of their receipts for overhead expenses, and should submit an annual audit to the appropriate state agencies. In the case of receiving schools, they must comply with federal anti-discrimination provisions (including race and national origin) and meet all state and local health and safety regulations.

- Finally, any legislation should ensure that the schools are doing the job. Receiving schools should either be accredited by a private accreditation organization or be required to administer an annual national norm-referenced achievement assessment in both reading and math for each grade available.

  In the alternative, the State Department of Education, with the concurrence of the State Board of Education, could develop a longitudinal analysis similar to that which is planned for the Washington, DC choice program. Such an analysis could evaluate academic performance, retention rates, dropout rates, graduation and college admission rates of students in the program compared with a similar cohort not in the program.

Educational Improvement Tax Credits:
No Lost Funding for Public Schools

What will an Educational Improvement Tax Credit "cost" state taxpayers?

Opponents of school choice argue that a tax credit will decrease revenues to the State Treasury, thereby reducing the funds available for public schools. But supporters of school choice make the point that if a child leaves the public schools the costs associated with that child also leaves, resulting in no net loss to the State Treasury.

Education spending in Virginia is divided between state, local, and federal contributions. Local funding is dependent upon decisions made by the local School Board and the local governing authority (Board of Supervisors or City Council). State funding includes both per-pupil funding that is based upon staffing requirements and then computed through the state's Local Composite Index (which is, in turn, based upon a locality's "ability to pay"), categorical funding, and a revenue stream from sales taxes that is based upon school-age population (including private and home-schooled students). Federal funding includes federal impact aid in areas with a high concentration of federal personnel and federal property, as well as aid based upon school age population and numbers living in poverty rather than public school enrollment numbers.

As a consequence, per pupil expenditures can vary tremendously from school division to school division.

In our prototype Educational Improvement Tax Credit, each scholarship given to a student is limited by the amount of per-pupil state aid spent by the state in the student's school division (not including any sales tax funding stream). As an example, if the state spends $2,700 per pupil in a school division, the amount of the private scholarship for students residing in that school division is limited to $2,700. The local contribution, the state sales tax and federal aid dependent upon school-age population funding streams remain with the local school division.

The state thus "saves" $2,700 it doesn't have to spend on that student. This is offset by the tax credit given to corporations for donating to a scholarship organization. In this example, the tax credit comes to roughly $2,700. This is calculated as follows: Because the scholarship organization can use 10% of its revenues for administrative overhead, it takes $3,000 in tax-credited donations to obtain the revenue for one $2,700 scholarship. As a consequence, the true cost of a $2,700 scholarship is $3,000. A 90 percent tax credit on a $3,000 donation consequently comes to $2,700.

State aid per pupil ranges from as little as $1007 in Fairfax City to as much as $4,967 in Lee County. In our prototype, a student using a scholarship to leave Fairfax City Public Schools would receive only $1,007, but a similar student in Lee County would receive nearly $5,000.

An important question is whether there will be enough scholarships large enough to make a difference in the decisions of parents and to help students find educational alternatives. The most successful scholarships offer up to $3,500 per student. Some, like Cleveland, offer between $2,700 and $3,000. Some private scholarships offer as little as $1,000. How many Virginia school divisions will fall into those different ranges?

Number of School Divisions	Range of Available Scholarships
57	Greater than $3,500
32	$3,000 to $3,499
19	$2,500 to $2,999
10	$2,000 to $2,499
7	$1,500 to $1,999
9	$1,000 to $1,500

Many of these scholarships may be too small to affect the decision-making of some parents, and clearly a thousand dollars won't underwrite the tuition at Andover. Yet, a 2002 study by the Clare Boothe Luce Institute suggested that a significant number of Richmond area neighborhood-based private schools offering a safe educational environment have tuition rates as inexpensive as $2,500.

Additionally, the privately-funded CHOICES scholarship program, operating in Virginia and offering $1,000 scholarships to help parents make educational decisions for their children, reports that even a relatively small level of funding can make a significant impact in the financial decisions of relatively low income families.

An Educational Improvement Tax Credit will help those students who choose an alternative educational environment that better addresses their learning needs. More importantly, it will *not* hurt the state's ability to fund public schools elsewhere.

Educational Improvement Tax Credits: Generally Positive Results for Local School Systems

Determining savings or losses at the local level is more complex. Local per-pupil school expenditures include both fixed costs (such as transportation or building operating costs, debt service, certain administrative costs, etc.) that remain if only a limited number of students leave a school system, and variable costs (such as teacher salaries and supplies) that rise or fall based on the number of students in a classroom. Whether a school division is financially helped or hurt by departing students depends upon the relationship between those fixed costs that remain and the variable costs that disappear.

Even variable costs can fluctuate wildly. For example: Because of class size limitations, a single fourth grade student leaving a school with two 20-student classes will have a limited impact. However, because the state "caps" 4th grade classrooms at 35 children, a fourth grade student leaving a school with two 18-student classes would potentially save the school division the cost of a second teacher or possibly even the need to rent a trailer for additional classroom space.

Because no formula exists in Virginia for determining the proportion of fixed vs. variable costs, we considered a surrogate devised in 1995 by the University of Texas at Austin's Dr. Chrys Dougherty and researcher Stephen L. Becker (MBA, University of Texas) that used data supplied by the Texas Education Agency (TEA). The pair examined the average incremental increase in total cost at each individual school when enrollment increased by one student, calculating from that the fixed and variable costs for elementary schools, middle schools and high schools. The variable cost ranged from 82 percent of per pupil cost in an elementary school located in a small school division to 94 percent in a middle school located in a large school division.[30]

In addition, a 2004 econometric study by Dr. Cotton Lindsay, of Clemson University, concluded that the marginal (or variable) classroom cost of educating a student in South Carolina was in excess of 90 percent. Dr. Cotton re-affirmed his conclusions in 2005 after examining three years worth of data. However, his studies did not incorporate central district office expenses.[31]

We also examined the recent experience of several Virginia school divisions that had seen student membership rise or fall and the budgetary effects the school system imputed to those membership changes. The variable costs ranged from the mid-seventies to, most recently, 91 percent of the per-pupil costs in Fairfax County when the school division there adjusted its projected enrollment downward.[32]

These figures struck us as overly optimistic, however. In a small school division or a small school – as are most Virginia schools – the variable costs were likely to be much lower.

To obtain a more accurate picture, we consulted the Virginia Department of Education Superintendents Annual Report. Table 13 of that report offers a breakdown of disbursements by school division and by category. Some categories (Adult Education, Facilities, Debt Service, Pupil Transportation, Administration) are composed nearly totally of fixed costs. Others (School Food Services, Attendance and Health Services, Technology teachers, Summer School) have a small component of variable costs. The category of Instruction (representing expenditures for

classroom instruction, guidance services, social work, books, instructional improvements, etc.) has a high percentage of variable costs.

Additionally, given the fact that students choosing a private school under an Educational Improvement Tax Credit program will be high poverty and also likely be over-represented with students requiring English language and special education services, we felt secure in using the self-reported "Instructional Costs" as a surrogate for variable costs in each school division. These are, in fact, the per-pupil costs most likely to disappear when a high-poverty, at-risk student leaves a public school system.

In computing the fiscal effects of an Educational Improvement Tax Credit on each school division, we considered the current local contribution per pupil, the fixed costs that would remain in a school division, and the revenue from state retail sales and use tax.

Sales tax distribution is computed by school-age population within a school division: Revenue continues to flow for each school-age child, whether that child is in public, private, religious schools or home-schooled. Thus, a school division continues to receive that revenue stream, even if a current student transfers to private school. The same is also true for much of the federal aid.

In short, for each child who would leave the school system, the local school division would lose the state and potentially some federal dollars that child would normally bring. The local contribution and the sales tax remain in the school division, as do the fixed costs of education. The result was a formula for each school division that read –

(Local Contribution Per Pupil)	+	(Sales and Use Tax Per Pupil)	-	(Fixed Costs within total per Pupil Expenditure)	=	(Money Remaining Per Pupil)

As an example, the attached chart shows for Accomack County a Total Per Pupil Expenditure of $8,988, a local contribution of $3,117, a fixed percentage of student costs of 32.9%, and retail sales and use tax revenue per pupil of $891. Thus, the formula indicates –

$$\$3,117 + \$891 – (.329 \times \$8,988) = \$1,051$$

In this case, the Accomack County School system, after paying for the fixed costs, would have $1,051 from state sales and local funding for each student who transferred to private sector schools – funds that would then be available to meet help other students in the public schools.

The fiscal effect of an Educational Improvement Tax Credit on local school divisions is less uniform than the effect on state funding. Of 136 school divisions, 33 would derive a net gain of more than $2,500 for each student who chooses to transfer (some as high as $9,118), 64 would have between $1,000 and $2,499 available for redirection to other uses; 21 would have between than $500 and $999; 18 would have less than $500. Of this latter category, seven school divisions would actually *lose* money through an Educational Improvement Tax Credit.

The seven school divisions that lose money are among the smallest in the Commonwealth, with only 18,000 students between them. They also are among those areas with the fewest number of available private schools and thus are least likely to see students migrate away from their systems. *Even if all 18,000 students in these seven divisions were to leave their*

public schools, the net "loss" would be about $3 million. The State can easily create a "hold harmless" provision to fund these schools for a period of time to accommodate any loss of funding.

No claim is made that this is a perfect measure. Indeed, the amount of money left in a local school division if only one or two students choose to leave could be substantially more (if it eliminated the need for a teaching position) or loss (if it made no staffing change). However, since the high-poverty students who can make use of such tuition scholarships are also among the most expensive to educate, their departure from the school system is more likely to have a positive impact on a school system's finances than the departure of an "average" student.

It is clear, however, that a tuition scholarship will generally not have a negative effect on local school finances and is, indeed, more likely to have a positive effect. In the overwhelming majority of school divisions, funds will remain in the local division – even after paying for the fixed costs of a student's education – available to redistribute for the education of other students.

Fiscal Effects of a Virginia Educational Improvement Tax Credit

School Division	Total Per Pupil Expenditure	Local Contribution Per Pupil	State Aid Per Pupil	State Sales Tax Per Pupil	Fixed cost Percentage in Division Budget	Money Remaining Per Pupil
Accomack	$8,988	3,117	$3,859	891	32.9	$1,051
Albemarle	9,433	6,374	1,848	735	33.0	3,996
Alleghany	8,415	3,208	3,949	678	29.6	1,395
Amelia	7,361	1,962	3,758	757	28.5	621
Amherst	7,258	2,250	3,634	762	24.2	1255
Appomattox	6,945	1,722	3,905	703	31.0	272
Arlington	15,977	13,258	1,245	733	30.6	9,118
Augusta	7,144	2,588	3,174	734	24.6	1,572
Bath	11,306	8,424	1,331	689	34.5	5,212
Bedford*	6,559	2,577	2,831	679	26.0	1,550
Bland	7,727	1,930	4,438	678	30.0	290
Botetourt	7,613	3,573	2,947	757	24.6	2,457
Brunswick	8,623	2,165	4,344	804	31.7	235
Buchanan	8,307	1,977	4,470	655	30.3	115
Buckingham	7,803	1,545	4,389	751	29.9	-38
Campbell	7,023	2,379	3,434	712	27.2	1,180
Caroline	7,730	2,755	3,400	706	28.8	1,235
Carroll	7,903	2,406	3,843	729	28.7	866
Charles City	11,289	6,536	3,095	776	34.4	3,428
Charlotte	7,485	1,536	4,379	656	33.4	-308
Chesterfield	7,141	3,336	2,779	657	29.7	1,850
Clarke	8,234	4,832	2,239	710	27.7	3,261
Craig	7,830	2,367	3,856	822	28.0	996
Culpeper	7,514	3,409	2,937	710	23.9	2,323
Cumberland	8,664	2,055	3,932	909	38.4	-363
Dickenson	8,560	2,248	4,207	684	37.0	-236
Dinwiddie	7,231	2,420	3,551	635	29.9	892
Essex	7,825	3,088	3,079	763	28.6	1,613
Fairfax	10,770	8,296	1,261	762	31.9	5,622
Fauquier	8,601	5,420	2,065	745	24.9	4,023
Floyd	7,358	2,534	3,551	689	29.5	1,052
Fluvanna	7,117	3,073	3,060	578	25.5	1.836
Franklin	7,324	2,832	3,135	709	29.1	1,409
Frederick	8,345	4,299	3,008	665	27.8	2,644
Giles	7,210	2,633	3,304	738	30.6	1,164
Gloucester	7,470	2,864	3,343	747	28.8	1,459
Goochland	8,538	6,250	1,103	709	28.5	4,525
Grayson	7,975	2,040	4,241	707	26.1	665
Greene	8,084	2,999	3,725	712	23.9	1,778
Greensville*	8,470	1,771	4,508	724	28.8	55
Halifax	8,493	2,541	4,448	730	32.2	536
Hanover	6,925	3,614	2,381	661	24.5	2,578
Henrico	7,105	3,798	2,251	705	28.5	2,478

School Division	Total Per Pupil Expenditure	Local Contribution Per Pupil	State Aid Per Pupil	State Retail Sales and Use Tax Per Pupil	Percentage of Budget that is Fixed Costs	Money Remaining Per Pupil
Henry	7,286	2,001	3,762	790	27.7	772
Highland	9,481	4,369	2,274	787	29.0	2.406
Isle of Wight	7,706	3,449	2,946	788	27.4	2,122
James City *	8,240	5,748	1,754	739	31.0	3,932
King George	7,178	3,128	3,013	656	27.3	1,824
King & Queen	10,141	4,215	3,995	774	33.6	1,581
King William	7,993	3,192	3,636	691	23.6	1,996
Lancaster	8,543	4,943	1,989	753	30.1	3,124
Lee	8,002	1,079	4,967	744	24.0	-98
Loudoun	10,344	7,822	1,580	671	28.8	5,513
Louisa	7,705	4,447	1,962	776	30.7	2,857
Lunenberg	8,329	2,077	4,492	803	28.2	531
Madison	7,706	3,138	3,306	770	30.0	1,734
Mathews	7,309	3,038	2,961	710	28.7	1,650
Mecklenburg	7,551	2,281	3,808	678	28.4	814
Middlesex	7,747	3,785	2,508	760	31.1	2,135
Montgomery	7,778	3,295	3,123	793	27.3	1,964
Nelson	8,482	4,107	2,822	801	29.3	2,422
New Kent	7,219	3,218	2,904	734	30.5	1,750
Northampton	8,662	2,506	4,000	791	25.6	1,079
Northumberland	7,967	4,125	2,282	723	27.4	2,665
Nottoway	7,204	1,291	4,078	782	32.6	-276
Orange	7,581	3,388	2,960	737	26.9	2,085
Page	7,039	2,233	3,541	681	27.8	957
Patrick	7,431	2,061	3,893	684	30.8	456
Pittsylvania	6,690	1,655	3,684	746	28.2	514
Powhatan	7,721	3,827	2,897	691	32.2	2,031
Prince Edward	7,629	2,153	3,756	782	29.9	707
Prince George	7,077	1,927	3,672	677	32.0	339
Prince William	8,266	4,056	3,155	672	28.2	2,396
Pulaski	7,413	2,371	3,359	750	33.7	616
Rappahanock	8,918	5,879	1,746	859	26.8	4,347
Richmond	7,448	2,997	3,226	652	28.4	1,533
Roanoke	7,778	3,816	2,869	735	24.6	2,637
Rockbridge	8,334	3,883	3,056	736	29.1	2,193
Rockingham	7,826	3,425	3,033	809	24.6	2,308
Russell	6,986	1,383	3,843	766	30.2	39
Scott	7,035	1,277	4,284	683	29.0	-81
Shenandoah	7,106	2,941	3,018	706	24.3	1,920
Smyth	6,809	1,506	3,901	753	21.0	829
Southampton	8,122	2,676	3,910	839	31.9	924
Spotsylvania	7,296	3,314	2,920	702	25.6	2,148

School Division	Total Per Pupil Expenditure	Local Contribution Per Pupil	State Aid Per Pupil	State Retail Sales and Use Tax Per Pupil	Fixed Cost Percentage in Division Budget	Money Remaining Per Pupil
Stafford	7,028	2,937	3,081	669	26.2	1,764
Surry	11,940	9,183	1,335	638	34.5	5,701
Sussex	11,076	5,519	4,047	647	35.8	2,200
Tazewell	7,060	1,536	3,983	712	29.9	137
Warren	7,060	2,829	2,027	722	27.5	1,609
Washington	7,072	2,411	3,308	620	27.7	1,072
Westmoreland	7,320	2,566	3,138	790	32.1	1,006
Wise	7,701	1,776	3,921	711	28.3	307
Wythe	7,440	2,270	3,667	724	27.0	985
York	7,453	3,077	2,782	641	33.6	1,213
City Of:						
Alexandria	14,479	11,634	1,212	765	31.6	7,823
Bristol	8,317	3,399	3,222	722	25.0	2,041
Buena Vista	8,191	2,844	4,086	703	30.7	1,032
Charlottesville	12,155	7,669	2,428	933	27.8	5,222
Colonial Heights	8,684	5,080	2,534	703	24.2	3,681
Covington	10,150	4,880	3,712	677	25.8	2,938
Danville	8,247	2,716	3,153	854	27.7	1,285
Falls Church	13,949	11,700	1,162	717	30.2	8,204
Fredericksburg	9,578	6,184	1,692	659	27.3	4,228
Galax	7,186	2,464	3,369	546	32.3	688
Hampton	7,847	2,686	3,723	810	29.1	1,212
Harrisonburg	9,229	5,389	2,330	696	26.9	3,602
Hopewell	8,102	2,584	3,992	724	26.9	1,128
Lynchburg	8,220	3,167	3,186	899	27.7	1,789
Martinsville	8,580	2,811	3,761	813	30.0	1,050
Newport News	7,593	2,471	3,620	866	27.6	1,241
Norfolk	8,415	2,686	3,783	805	25.8	1,319
Norton	8,518	2,372	4,186	735	26.2	875
Petersburg	8,142	1,953	4,367	643	30.4	120
Portsmouth	7,827	1,832	4,285	688	31.4	62
Radford	7,630	2,975	3,468	627	27.1	1,534
Richmond	10,710	5,526	3,070	882	30.7	3,122
Roanoke	8,553	3,524	3,429	740	24.0	2,211
Staunton	8,560	3,711	3,208	881	22.4	2,674
Suffolk	7,264	2,310	3,531	760	27.5	1,072
Virginia Beach	7,951	3,573	2,909	734	27.9	2,088
Waynesboro	7,858	3,411	2,997	729	26.9	2,026
Williamsburg*	12,118	5,861	1,394	684	31.0*	2,788*
Winchester	10,040	6,159	2,466	701	26.1	4,239
Fairfax	10,393	8,616	1,007	770	31.7*	6,091
Franklin	9,158	3,078	4,116	661	27.0	1,266
Chesapeake	7,724	3,264	3,167	746	24.7	2,102
Lexington	7,276	3,504	2,750	536	20.9	2,519

School Division	Total Per Pupil Expenditure	Local Contribution Per Pupil	State Aid Per Pupil	State Retail Sales and Use Tax Per Pupil	Percentage of Budget that is Fixed Costs	Money Remaining Per Pupil
Emporia*	7,762	3,019	4,003	740	20.9	2,136
Salem	8,131	4,337	2,658	700	25.9	2,947
Bedford*	6,014	1,689	3,612	713	29.8	609
Poquoson	6,960	2,942	3,019	643	28.4	1,608
Manassas	9,121	5,012	3,025	729	24.9	3,469
Manassas Park	9,021	4,135	3,773	655	30.0	2,083
Town of:						
Colonial Beach	7,732	1,998	3,671	586	25.6	604
West Point	8,746	4,085	3,764	542	26.7	2,291

* -- 2004 is the first year that fiscal data has been disaggregated by the state between the jointly-operated school systems of Greensville County and the City of Emporia, and between James City County and the City of Williamsburg, Bedford County and the City of Bedford.

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About the Author

Chris Braunlich is vice president of the Thomas Jefferson Institute for Public Policy, Virginia's premier non-partisan public policy foundation. He served eight years on the Fairfax County School Board, the nation's 12th largest school system, where he was a strong advocate of educational accountability and research-based reading programs.

Mr. Braunlich has served as Chief of Staff to Congressman John LeBoutillier, Assistant Vice President of Public Affairs for the National Association of Manufacturers, president of the Alexis de Tocqueville Institution, and vice president of the Center for Education Reform. His articles have appeared in dozens of publications, including *The Washington Post, The Baltimore Sun, The Northern Virginia Journal, The Washington Times,* and *The Fredericksburg Free Lance-Star*.

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"... a wise and frugal government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities."

Thomas Jefferson

1801

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