

Funding School Choice

Vouchers or Tax Credits: A Response to Buckingham

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A growing body of evidence points to school choice reforms as the best hope for improving schooling in Australia, but questions remain over how to fund them.

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School choice reforms aim to improve the availability of information about school quality to parents, enable greater competition in the provision of education services, and allow parents more choice in how their children are educated.

These reforms can be achieved, in part, through the introduction of an education voucher or tax credit system. First advocated by Milton Friedman in 1955, a voucher is essentially an education bursary to each parent that can be used to pay for their children's education. A tax credit allows parents to claim education costs (up to a pre-set level) against their tax liability. Such direct assistance would replace current school funding and would give parents the means (combined with their own contributions) to afford to send their children to a broad range of competing schools. The advantages of such reforms would include greater diversity and innovation in education, more effective and efficient schools, greater choice for parents, and more active parental involvement in their children's education.

This article accepts the arguments for school choice policies, as outlined by Jennifer Buckingham in the Spring 2001 issue of *Policy*,¹ and focuses on some outstanding issues within the school choice movement: (i) whether vouchers or tax credits should be preferred by school choice advocates; (ii) how school choice policies can be paid for; and (iii) what further reforms can be pursued in the medium to long term.

Vouchers or tax credits?

Assuming the acceptance of moving towards a school choice system, and the need to retain public funding

tied to education, it is important to consider whether tax credits or vouchers should be preferred.

Buckingham draws on the work of Andrew Coulson² in her discussion of vouchers versus tax credits, concluding that tax credits are preferable as they allow for greater school autonomy, direct parental financial responsibility, more downward pressure on education costs, and reduced administration costs. It is unlikely, however, that these issues would be significantly different under either system. Moreover, a tax credit system would add to the complexity of the Australian tax system, reduce the transparency of government activities, create cash-flow problems for low-income families, and may not be possible under current Commonwealth-State intergovernmental arrangements.

School autonomy. Some argue that a voucher system may lead to diminished school autonomy compared with a tax credit system. Using either a direct expenditure (education voucher) or a tax expenditure (education tax credit), the government will still provide financial assistance to parents who fulfil the necessary requirements. This will necessitate a degree of government regulation as to what institutions or arrangements are appropriate for educational purposes.

It seems unlikely that there would be any stricter standards under a voucher system than a tax credit

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system, or under the current system. Indeed, in the United States, restrictions on the Milwaukee voucher programme have actually decreased and attempts to increase them again have been defeated.³

Parental financial responsibility. Another argument in favour of tax credits is that ‘tax credits do a better job of preserving direct parental financial responsibility’,⁴ resulting in greater parental involvement in education. Schools are also more likely to respond to the needs of the parents and less likely to lobby the government.

These benefits seem marginal. While it is true that education institutions are likely to lobby for an increase in a voucher if it is introduced, they are equally likely to lobby for an increase in a tax credit. Furthermore, both a voucher and a tax credit system ensure that schools are more responsive to parents, as parents would directly control school funding through choosing a school for their child. It is this increased ability to influence schools, and the greater choice between schools, that will encourage parents to become more involved in their children’s education, not the medium through which they gain their benefit.

Downward pressure on education costs. It is claimed that a voucher may eliminate the possibility of downward pressure on prices, as schools would have no incentive to offer education at a cost below the level of the voucher. This is a problem not only with vouchers, but also with a tax credit system. While schools may not compete on prices below the voucher amount, they will still have an incentive to compete on quality—and so such a distortion would not reduce educational efficiency. The way to avoid such a problem is to ensure that the level of the benefit is lower than the current cost of education. This can be justified on the basis that there are private as well as public benefits from education and so some level of private payment is appropriate, given that the fiscal cost of providing a full cost voucher is unaffordable.

Reduced administration costs. Buckingham suggests that administration and economic costs may be higher under a voucher system compared with a tax credit system. This seems unlikely as both systems would involve similar levels of administration and both would include the distortionary effects of taxation. Under both systems, tax would be raised by the taxation office, creating the same distortions and requiring the same administration. Bureaucrats would have to administer the distribution of benefits back to taxpayers, either with an outlays

programme through another department, or with a refund in a different area of the taxation office.

Hidden costs. There are additional relative costs of a tax credit over a voucher system. An education tax credit would add further to the complexity of our tax system, which already includes four large volumes with a total of nearly 9,000 pages of income tax legislation.⁵ We should be simplifying our tax system with a lower rate and less rebates and deductions, as recently suggested by CPA Australia in their tax policy paper.⁶

Buckingham suggests that ‘in terms of government finance, revenue not collected is the same as revenue spent’.⁷ This is not strictly true. Welfare policies paid through the tax system (a tax expenditure) hide the true size of government. While official government publications claim that the Commonwealth Government had expenses totalling \$156.8 billion in 2000-01 (23.4% of GDP),⁸ if we include the costs of tax expenditures then the total is \$186.4 billion for 2000-01 (27.8% of GDP).⁹ Allowing a government to hide such programmes adversely affects efficient and transparent governance.

Low-income families. Vouchers are also preferable to tax credits as they offer better assistance to low-income families. Under a tax credit system, recipients would not usually receive the benefit until they receive their tax return, several months after the end of the financial year in which they paid their tax. For many struggling families this timing issue is likely to be of some concern. A voucher could be paid during the year, or at regular intervals throughout the year, resolving this timing issue.

Commonwealth/State government responsibilities. Under a tax credit system the issue remains what tax liability is to be offset. School education is currently a State responsibility. This appears to rule out the most obvious candidate for a tax offset—individual income tax—while taxes administered by Australian States and Territories seem inappropriate for any tax credit scheme. Transferring all school funding responsibilities to the Commonwealth government is problematic and would make it more difficult to achieve school choice reform in Australia: it would be possible to introduce a voucher system in a single state, but a tax credit system would require unanimous agreement between all governments.

Even if it were possible to centralise education funding, is such a move desirable given the advantages of competitive federalism? Inter-state competition on school funding

levels and regulatory arrangements would lead to increased choice for families. A decentralised system also allows experiments in schooling systems. This is beneficial, for it increases the probability of a good new policy being attempted, and ensures that bad new policies are quickly recognised, quarantined and removed.

Australia is not America. Many of the above arguments are unique to Australia. In the United States, for example, there may be constitutional issues regarding public funds being used on religious schools, and many states have individual income taxes that the tax credit could reasonably be used to offset. In this light it is understandable that Andrew Coulson concludes that 'education tax credits appear . . . to offer the best hope.'¹⁰

The Australian situation is somewhat different. There seems little reason to believe that administration costs, school responsiveness or government restrictions would be any different under either a voucher or tax credit system. Vouchers should therefore be preferred to tax credits as they do not increase the complexity of the tax system, are more transparent, are more effective at assisting low-income families, and avoid problems with Commonwealth-State arrangements.

The cost of school choice

A voucher system aims to fund each student at a constant rate, no matter which school they attend. As the effective student subsidy is currently inconsistent for Australian students (depending on their school), this will require either an increase in the cost of public education expenditure or some students will receive less than they did previously.

Buckingham recognises this issue, and addresses it by stating that 'these extra outlays would, at least in part, be offset by the efficiency of directing funding through families, and the downward pressure on schooling costs as a result of competition between schools.'¹¹ This implies that although some students will receive less than they did previously, they may not be worse off as the cost of education will have gone down.

Buckingham argues that a private school could provide a better education at the same cost as a public school, or could supply the same education as a public school for a lower cost. There is much evidence to

support this argument. Indeed, Buckingham shows quite effectively that 'all student-related factors being equal, private school students still perform better'.¹² Moreover, private education has been, on average, cheaper per student than public education. In the United States, private education per student costs are about half that of public education,¹³ but private schools still achieve better outcomes.

Reprioritise government spending. Another option is to raise public education expenditure to ensure that no child receives less public assistance. While it is unlikely that a government could afford to increase the voucher to this level,¹⁴ some increase in education funding could be considered as part of a school choice policy, depending on the ability of a government to reprioritise its expenditure. Federal Labor MP Mark Latham promoted such a reprioritisation when he suggested that money saved by reducing corporate welfare could go towards education.¹⁵ While neither of the major political parties has been willing officially to take such a stance, the Liberal

Democratic Party included school choice in their recent platform in the ACT election, suggesting a shift of funds from the government's bus monopoly into a school voucher.

A targeted system. Another way of reducing the cost of a voucher system is to introduce a targeted system—that is, offering vouchers only to those who pass a means-test. This would be less costly, but it would also increase effective marginal tax rates and administrative cost; it also violates the previously stated goal of treating all children equally.

Further reforms

Writers such as James Tooley¹⁶ and David Friedman¹⁷ have argued convincingly for a privatised and unfunded education system. While such arguments are persuasive, they represent the most radical option of no government involvement. Several options lie between vouchers and a full privatisation, depending on the answers to three questions: (i) should funding be tied to education spending? (ii) should there be a distribution from non-parents to parents? and (iii) should there be redistribution of income towards low-income earners?

In the United States, private education per student costs are about half that of public education.

If the answers to all three are 'no', then this could be achieved by removing all public education expenditure and reducing taxes—the position outlined by Tooley and Friedman. There are, however, two other possible options between vouchers and a totally private system.

(i) The voucher system ties funding to education spending, redistributes from non-parents to parents and redistributes towards low-income earners.

An alternative might be to continue to distribute towards parents and towards low-income earners, but to end the tying of funds to education. Under this system, which Buckingham considers in *Families, Freedom and Education* (2001),¹⁸ the government would lose control over how people spend that additional money. People would be given maximum choice as to whether they spend their additional funds at a government approved school, an alternative educational facility, or on other family priorities such as health or housing. By contrast, under either the voucher or tax credit system, the benefit accrued only if certain activities were undertaken and so the government exerted some influence over the behaviour of families.

This option would remove all restrictions on education options and introduce greater choice. It could be provided through a cash payment to parents, or through a tax offset to parents, or both, as with the current Family Tax Benefit.

(ii) Another option would be to continue to distribute towards low-income earners, but to end the tying of funds to education and remove the distribution towards parents.

The desirability or otherwise of this option rests largely on the issue of whether families without children should be forced to cross-subsidise families that choose to have children. The government currently offers considerable support to families; Tom Nankivell estimates the subsidy to parents can exceed \$100,000 per child to age 18, and questions on what grounds childless people are forced to pay for this.¹⁹

This option totally separates the issue of education from income redistribution. While all government involvement in education could end, the government could continue to redistribute money in such a way that the disadvantaged would still have sufficient resources to afford decent education. This would be achieved by removing the vouchers from tax-paying families and reducing their tax, and removing vouchers from welfare recipients and increasing welfare payments.

The above approach is able to claim real benefits over both the voucher and tax credit systems—such as a reduced tax burden, lower administrative costs, reduced complexity, removal of unjustifiable family cross-subsidies and extension of real choice without the possibility of government involvement—while maintaining redistribution to assist disadvantaged families.

Such options may appear preferable to a voucher, but they remain outside the scope of pragmatic reform that we might see in Australia's near future and could be considered instead medium- to long-term goals. In the short-term, it seems that vouchers remain the best chance for school choice reforms.

Endnotes

- ¹ J. Buckingham, 'The Case for School Choice: And How To Fund It', *Policy* 17:3 (Spring 2001), 18-24. Also J. Buckingham, *Families, Freedom and Education: Why School Choice Makes Sense* (Sydney: The Centre for Independent Studies, 2001).
- ² A. Coulson, *Towards Market Education: Are Vouchers or Tax Credits the Better Path?*, Policy Analysis No. 392 (Washington, D.C.: Cato Institute, 2001).
- ³ A. Coulson, *Towards Market Education*, 5.
- ⁴ A. Coulson, 13.
- ⁵ The latest edition (2002) of Australian income tax legislation.
- ⁶ CPA Australia, www.cpaonline.com.au
- ⁷ J. Buckingham, *Families, Freedom and Education*, 72.
- ⁸ Treasury, 2000-01 Final Budget Outcome (Canberra: Treasury, 2001).
- ⁹ The 2001 Tax Expenditure Statement reports that there are about 250 tax expenditures totalling nearly \$30 billion.
- ¹⁰ A. Coulson, *Towards Market Education*, 14.
- ¹¹ J. Buckingham, 'The Case for School Choice', 20.
- ¹² J. Buckingham, 'The Truth about Private Schools in Australia', *Issue Analysis* No. 13 (Sydney: The Centre for Independent Studies, 2000).
- ¹³ A. Coulson, *Towards Market Education*, 12.
- ¹⁴ And it is questionable whether they would want to. As outlined earlier, by having the voucher at a level lower than the cost of education, there would be downward pressure on the cost of education.
- ¹⁵ M. Latham, *What Did You Learn Tod@y?* (Sydney: Allen and Unwin, 2001).
- ¹⁶ J. Tooley, *Education Without the State* (Manchester: IEA Education and Training Unit, 1996).
- ¹⁷ D. Friedman, *The Weak Case for Public Schooling*, http://www.daviddfriedman.com/Libertarian/Public%20Schools/Public_Schools1.html
- ¹⁸ See pages 75–97.
- ¹⁹ T. Nankivell, 'Coughing Up for Mums and Dads', *The Australian* (20 June 2000).