

**Fiscal Effects of the Proposed Succeed Scholarship
Program on Arkansas State Education Expenditures
and Local School Districts**

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Summary

Representative Douglas House has introduced House Bill 1552 to create the Succeed Scholarship Program that would permit students with disabilities attending public schools to transfer to an approved private school of their parent's choosing with the support of the student's full foundation funding to cover school tuition and fees. Policy makers are interested in the effect that this private school choice program likely would have on overall state finances as well as the fiscal health of affected public schools. Drawing upon the state education funding formulas as well as the provisions in the bill, we are able to determine that the effect of the program on the state budget is likely to be positive after the initial startup year. The program's effect on the fiscal condition of individual districts is forecast to be positive in the overwhelming majority of cases and very small, as the modest number of students that are expected to utilize the Succeed Scholarship Program are likely to be spread out across the 230 school districts of Arkansas.

Background

Private school choice programs are government initiatives that provide resources to families that assist them in choosing a private school for their child to attend. The first private school choice programs were introduced in Vermont (1869) and Maine (1873). In both cases, the purpose of these "town tuitioning" programs has been to allow students in rural areas to attend private schools of their parent's choosing if a public school does not exist in their community. These private school choice programs have operated continuously for over 140 years and enrolled 2,608 students in Vermont and 5,646 students in Maine during the 2012-13 school year. The first private school choice program targeted to low-income students was established in Milwaukee in 1990.

The number and size of private school choice programs have increased dramatically recently. As of January, 2015, a total of 43 such programs operate in 24 states and serve over 340,000 students. In addition to town tuitioning and school voucher programs, private school choice initiatives can take the form of tax-credit funded scholarships or Education Savings Accounts, where a portion of the funds that the government otherwise would spend on a student in a public school is placed in a dedicated expenditure account managed by their parents.

Many of the existing private school choice programs are limited to students with disabilities. The first such initiative, the John M. McKay Scholarships for Students with Disabilities Program, was established in Florida in 1999. Currently there are 14 private school choice programs that target students with disabilities, including initiatives in the southern states of Florida, Georgia, North Carolina, South Carolina, Mississippi, Louisiana, and Oklahoma.

Fiscal Impact on States in General

Regardless of the form that private school choice takes, it involves state funds being directed to private schools through the decisions of parents. Thus, private school choice programs change

the fiscal reality of education. Some opponents of private school choice argue that such programs have a negative fiscal impact on the state because it requires that the government support two parallel systems of education – one publicly managed and the other privately managed.ⁱ Supporters of private school choice counter that such programs are guaranteed to save money for states because the private school sector already exists (it does not have to be built with state funds) and the amount of money that each student is eligible to take to a private school is always substantially less than the amount that would be spent on them if they remained in a public school.ⁱⁱ University of Arkansas Professor Robert Costrell has determined that the Milwaukee private school choice program saves the state of Wisconsin over \$50 million per year.ⁱⁱⁱ In a more extensive analysis of the fiscal impact of 10 school voucher programs across the U.S., Jeff Spalding of the Friedman Foundation for Educational Choice has concluded that those programs have generated “a cumulative total savings of at least \$1.7 billion...since 1990-91.”^{iv}

The amount of savings to the state generated by a given private school choice program will depend on how much more cheaply it is for the state to educate the average participating child in the private sector compared to the public sector times how many students participate. The average cost differential for the state per student will depend on the state’s school funding formula and the specific provisions of the program. For the remainder of this policy brief, we examine the fiscal impact in Arkansas that is likely should HB 1552 be enacted and the Succeed Scholarship Program be implemented.

Fiscal Impact of the Succeed Scholarship Program in Arkansas

The school funding formula in Arkansas is a Foundation Formula, whereby the State guarantees each district will have adequate per pupil funding. The foundation funding amount is scheduled to be \$6,646 for the 2016/17 school year when Succeed Scholarships first would be available.

Each district must tax local property at a base rate of 25 mills. The tax revenue from this levy is fixed in that it does not vary with the size or characteristics of the student population in the district. A district’s tax yield from its local level only varies based on the assessed value of property in the district. The state provides additional funding to each district to ensure that it achieves the foundation amount per student, which currently is \$6,521 for 2014-15.

Students with special education diagnoses are assigned an Individualized Education Program (IEP) by a committee composed of school officials, medical personnel, and their parents. Students with disabilities typically require additional resources to fund the special services described in their IEPs and the state provides those resources to districts through a “census” funding formula based on the expected number of students with disabilities given total student enrollment in each district.¹ The census approach funds public school districts for the number of students with disabilities that they should have, based on population estimates.

¹ An exception is that excess costs are reimbursed for students in residential care facilities.

The alternative to the census approach, “capitation” funding, funds school districts for the number of students with disabilities that they actually do have. Many states, like Arkansas, use census funding for special education because they fear that capitation funding would produce a perverse incentive for districts to over-diagnose students with disabilities so that the district would be eligible for additional public funds. Census funding does not guarantee that a district’s students with IEPs will be funded fully, if the population of students actually diagnosed exceeds the number forecasted by the census approach. Since special education funding in Arkansas is not based on the actual number of students with IEPs enrolled in a given district, but on total district enrollments of all students, it does not change appreciably if students with IEPs utilize the Succeed Scholarship Program.

Although a student must have an IEP and be enrolled in an Arkansas public school in order to participate in the Succeed Scholarship Program, once they use a scholarship to enroll in a private school their IEP no longer would be in force. Private schools are not required to provide the specific additional services that are contained in an IEP and receive no extra money from the state or federal government for serving students with special educational needs. Parents of students with disabilities would be provided a choice due to the program: They could transfer their child to a private school that offers a certain level of support for students with disabilities, and leave their child’s IEP behind, or keep their child in their traditional public school with their IEP in force. It will be incumbent upon program administrators to communicate clearly to parents that their child with a disability can transfer to a private school under the program but the child’s IEP cannot.

Given the way that special education is funded in Arkansas, the net effect of the Succeed Scholarship Program on the state budget is expected to be positive. First, a dollar in foundation funding is saved for every dollar in scholarships paid to participants, suggesting no net fiscal impact simply based on foundation funding. Second, net savings to the state are likely once categorical funding is considered. The state provided over \$543 million in categorical funding for the 2013/14 school year which is an average of \$1,242 per student. Since categorical funding is based on school enrollment it will reduce state expenditures in the years after initial program implementation as Succeed Scholarship Students will no longer be included in the school enrollment counts. Additionally, any students using the scholarship to attend a school where tuition and fees total less than the foundation amount will generate savings for the state since the value of the scholarship will be the lesser of the two amounts. While administrative costs may offset some of these potential savings, enrollment in the program is not expected to be large enough to necessitate significant administrative expenses in the first 5 years.

Because the per-student funding in Arkansas is based on student enrollment in the previous year, Succeed Scholarship students will be double-funded the first year they utilize the scholarship—once in the public school they attended the previous year and once in the private school receiving the scholarship. This characteristic of the school funding formulas in the state guarantees a net cost to the state estimated to be \$531,680 in the first year of the program. The annual net fiscal effect of the program is expected to be a savings of \$48,466 in the second year and the cumulative effect is projected to be a savings of \$185,732 by the fifth year, assuming that 100

students enroll the first year and an additional 50 students enroll in each subsequent year. Projections for the first 5 years are shown in the table below, with additional details regarding the analysis methodology provided in the Appendix.

Projected Fiscal Effect of Succeed Scholarship								
School Year	Scholarship Students	First year scholarship users	Returning scholarship users	Foundation Amount	State Categorical Spending	Mean Scholarship Amount	Net Effect on State	Cumulative
2016/17	100	100	0	6646	1261	5317	(531,680)	(531,680)
2017/18	130	50	80	6751	1281	5401	48,466	(483,214)
2018/19	154	50	104	6858	1301	5486	146,293	(336,921)
2019/20	173	50	123	6966	1322	5573	227,481	(109,440)
2020/21	189	50	139	7076	1343	5661	295,173	185,732

Fiscal Impact on Local Districts

The likely fiscal effect of the Succeed Scholarship Program on individual districts is a bit more ambiguous. When a student leaves the district the school loses state foundation funding for that student in most cases.² Because foundation and categorical funding is based on verified student enrollments in the previous school year, for the first year after a student leaves a given school district the district still receives full funding for the student, even though they are being educated somewhere else. From the second year on, any funding connected to a student who has left no longer goes to the district. However, throughout this process, the district incurs lower costs as they have one less student to educate.

The costs that school districts incur can be divided into two categories. One category is fixed costs, those that do not vary with the number of students in the short run. Examples of fixed costs would be buildings, busses, and central administrative expenses. The other category is variable costs, those that vary directly with the number of students in the short run. Examples of variable costs would be supplies and food service expenses. If the revenue lost by the district exceeds the variable costs avoided when a student leaves, the district is financially harmed when a student transfers. If, however, the variable costs avoided exceed the revenue lost when a student leaves the district, the district is helped financially by the transfer. Obviously, all costs and expenditures can be adjusted in the long run, so the fiscal impact is likely to be stronger in the short run than over time as the district can make larger adjustments. The fact that the state foundation funding is determined on a per-student basis is a de facto recognition that a considerable portion of education expenses are indeed variable costs.

The proportion of costs that are fixed and variable varies based on the cost structure of the district and the way it has chosen to allocate its resources. To determine the likely fiscal impact on districts in Arkansas for each student who utilizes a Succeed Scholarship requires

² Exceptions would be for the small number of schools that need no state foundation funding.

determination of which of the district's current expenses are fixed and which are variable. We do this for Arkansas districts using the cost classification methodology pioneered by Georgia College and State University Professor Benjamin Scafidi^v as applied to the expense categories listed on Annual Statistical Reports on the Arkansas Department of Education (ADE) website.^{vi}

Professor Scafidi studied the actual cuts implemented by school districts that suddenly faced unexpected funding shortfalls, arguing the districts are signaling to us what their variable expenses actually are based on those decisions. His methodology is conservative in that it intentionally categorizes costs as fixed if they are not clearly variable, thus increasing the likelihood that we will find fiscal harm to districts from the Succeed Scholarship Program.

For the most recent two years of Arkansas education financial data the percentage of total expenses that are variable in individual districts range from 34% to 80% with a mean of 66%. This wide degree of variation comes from several sources: natural variation in school districts based on size and urban/rural locations, natural variations from year to year as debt is refinanced in some years and not others, and the somewhat subject classification of costs by district personnel for state reports. To calculate the district effects we assume one less student with an IEP had attended the school for the year and the district had received funding based on one less student enrolled the previous year. As such, the variation in cost structures across districts should not influence this analysis since the fiscal impact is calculated without changing the district's specific relationship between fixed and variable costs. Based on the expenses classified as fixed and variable for each district, a unique cost function can be constructed for each district of the form:

$$\text{Total Costs} = \text{Fixed Costs} + \text{Variable Cost per student} * \text{Number of students.}$$

Despite the simple functional form of the cost function, it should be relevant for small changes in enrollment given the district's current cost structure and resource use patterns. For the most recent two years of financial data, the variable cost per student across districts ranges from \$3,965 to \$14,435 with a mean of \$7,035 for 2012-13 and \$7,172 for 2013-14.

When a student with an IEP leaves a district the cost savings are likely higher than for the typical student since educating students with IEPs requires more resources. According to the Arkansas funding formula, however, there is no difference in the amount of the revenue reduction for losing a student with or without an IEP. In other words, the district loses a student with above-average costs but merely average revenue.

To estimate the fiscal effect of a Succeed Scholarship student leaving the district the first year effects are different from ongoing effects since the enrollment counts used for funding are based on the previous school year. We assume revenue is reduced by the foundation amount and other variable revenue in the form of categorical aid, all with a one year lag. We assume expenses are reduced by the variable costs plus the per student special education expenditures (denominator is number of students with an IEP.)³ Since no revenue reductions are experienced the first year all

³ For special education expenditures per student, the denominator is the number of special education students, not total enrollment.

districts realize a net financial benefit from each of their students who participates in the program due to the cost avoided when an IEP student utilizes the scholarship to transfer out of district.

$$\text{Net Benefit (Yr 1)} = \text{Sp Ed Exp/student} + \text{variable cost}$$

If the student who transfers out of district requires the same resources as the mean for IEP students these benefits range from \$8500 to \$28,638 with a median of \$11,622. The assumption that a student who uses the Succeed Scholarship requires the mean resource usage among IEP students is likely a restrictive assumption. The students most likely to be easily accommodated in private schools are those with IEPs requiring fewer specialized resources, so we have also calculated the same net benefits if the student utilizing the scholarship requires 75% and 50% of the expenditures as the mean student with an IEP. See the Appendix for additional details regarding our analysis methodology.

First Year Benefits to Districts

	Resource needs of IEP Student using Succeed Scholarship		
	100% of mean	75% of mean	50% of mean
min benefit	8,500	7,688	6,875
max benefit	28,638	23,148	17,658
mean benefit	11,912	10,575	9,238
median benefit	11,622	10,299	9,011
districts with net loss	0	0	0
districts with net benefit	230	230	230

Every year beyond the first year a student utilizes the Succeed Scholarship, the net benefit to the district needs to include the combined effect of the variable cost avoided and the variable revenue no longer received using the equation below.

$$\text{Net Benefit (Yrs 2+)} = (\text{Sp Ed Exp/student} + \text{variable cost}) - (\text{foundation funding} + \text{var revenue})$$

The first set of parentheses is the cost avoided and the second is the revenue reduction.⁴ This represents the net benefit to the district for each year from the second year and beyond, as long as the student utilizes the Succeed Scholarship. When this formula is applied to 2013/14 data only one district would experience a net financial loss from the Succeed Scholarship Program and 229 would see a net financial benefit.

Again, to relax the likely restrictive assumption we have calculated the benefit assuming students who transfer out require fewer resources than the mean IEP student. The table below shows the

⁴ For special education expenditures per student, the denominator is the number of special education students, not total enrollment.

net fiscal benefit (loss) to the district for each student utilizing a Succeed Scholarship based on financial data from the 2013/2014 school year.

Successive Years Net Benefits to Districts

	Resource needs of IEP Student using Succeed Scholarship		
	100% of mean	75% of mean	50% of mean
min benefit	(2,636)	(3,698)	(4,760)
max benefit	19,951	14,461	8,971
mean benefit	3,911	2,562	1,214
median benefit	3,846	2,531	1,204
districts with net loss	1	4	27
districts with net benefit	229	226	203

In all scenarios the vast majority of school districts in Arkansas experience projected net financial benefits when a Succeed Scholarship is used. Even under the most pessimistic assumptions the median benefit to a district is \$1,204 per student participant.

Oklahoma passed similar legislation that went into effect in 2011. In Oklahoma only 6 students utilized the program in the first year, when its legal status was in doubt, and currently the number of scholarships is under 400. The take up rate among eligible students in Oklahoma is about 0.4%. If Arkansas experiences a similar take up rate only about 200 students will utilize the program in the fifth year, which is slightly less than 1 student per school district on average. Thus, we can say with confidence that the fiscal impact of the Succeed Scholarship Program on public school districts in Arkansas will tend to be both positive and quite modest.

Appendix: Assumptions Used to Calculate Fiscal Impacts

State Level

- All Succeed Scholarship students require “average IEP” resource utilization. If a student using a scholarship requires special education resources that are below the average for all students with IEPs the scholarship savings will be smaller. If a student using a scholarship requires special education resources that are above the average for all students with IEPs the savings will be larger.
- A special provision is not added to the bill to immediately net out of district enrollment the number of students participating in the program. Absent such a provision, the costs to the state will be equal to the foundation amount times the number of participants for the first year, as the state will have to pay the district *and* the scholarship the foundation amount (\$6,646 in 2016/17).
- Foundation funding and per student categorical funding grows at 1.58% per year, which is the mean rate of growth in foundation funding over the past 5 years, and no other changes are made in the funding formulas.
- 100 scholarships are utilized the first year with attrition of 20% and 50 new students utilizing it each successive year.
- Mean scholarship amount is 80% of foundation funding for the year due to the fact that most private schools in Arkansas charge tuition and fees below the public school foundation amount.
- The ADE uses existing resources to administer the program. Any administrative costs incurred would reduce net benefits to the state.

District Level

- Current expenditures equal necessary costs, i.e. schools are already minimizing costs and operating on the technically efficient frontier. To the degree that these changes encourage schools to re-evaluate resource usage, efficiency gains may be realized.
- All Succeed Scholarship students require “average IEP” resource utilization. If a student using a scholarship normally would require below average special education resources in the public sector then the savings for the district will be smaller. If a student using a scholarship normally would require above average special education resources in the public sector then the savings would be larger. To test the sensitivity of our results to this assumption we also calculated the fiscal effects on districts assuming the average special education costs of transferring students would be 50% and 75% of the overall average for students with IEPs.
- Expenditures on the Annual Statistical Reports were classified as follows:
 - *Fixed Expenditures*: General Administration, Central Services, Maintenance & Operations of Plant, Student Transportation, Other District Level Support Services, School Administration, Facilities Acquisition and Construction, Debt Service, and Other Non-Programmed Costs.
 - *Variable Expenditures*: Total Instruction, Student Support Services, Instructional Staff Support Services, Food Service Operations, Other Enterprise Operations, Community Operations, and Other Non-Instructional Services.
- Revenue sources on the Annual Statistical Reports were classified as follows:

- *Fixed Revenue*: Total Unrestricted Revenue State and Local less Foundation Funding, Adult Education, Professional Development, Early Childhood, Magnet School, and Total Other Sources of Funds.
- *Variable Revenue*: Other Regular Education, Gifted and Talented, Alternative Learning Environment, English Language Learner, National School Lunch Act, Other Special Education, Career Education, School Food Service, Education Service Cooperatives, Other Non-Instructional Programs, and Total Restricted Federal Sources.

ⁱ <http://onlinelibrary.wiley.com/doi/10.1002/%28SICI%291520-6688%28199822%2917:3%3C373::AID-PAM1%3E3.0.CO;2-D/epdf>

ⁱⁱ <http://www.edchoice.org/Research/Reports/The-School-Voucher-Audit--Do-Publicly-Funded-Private-School-Choice-Programs-Save-Money-.aspx>

ⁱⁱⁱ <http://www.uaedreform.org/the-fiscal-impact-of-the-milwaukee-parental-choice-program-2010-2011-update-and-policy-options/>

^{iv} <http://www.edchoice.org/Research/Reports/The-School-Voucher-Audit--Do-Publicly-Funded-Private-School-Choice-Programs-Save-Money-.aspx>

^v <http://www.edchoice.org/CMSModules/EdChoice/FileLibrary/796/The-Fiscal-Effects-of-School-Choice-Programs.pdf>

^{vi} http://www.arkansased.org/divisions/fiscal-and-administrative-services/publication-and-reports/report_categories/annual-statistical-reports