

EDCHOICE
FISCAL IMPACT STATEMENT
PENNSYLVANIA 2020 BUDGET SESSION

Note Prepared: March 25, 2020

Subject: HB 800, a bill to expand tax-credit scholarships in Pennsylvania

Impact: State, Local Taxpayers, and School Districts

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MEASURE’S PURPOSE: This bill, if enacted, would expand Pennsylvania’s Educational Improvement Tax Credit (EITC) program. The bill makes changes to student eligibility and funding limitations. There are at least three changes to the bill with fiscal implications to taxpayers and public school districts.

- 1) The bill changes the definition of “maximum annual household income” by increasing the amount for a student in either program from \$85,000 to \$95,000, plus the applicable income add-on for additional children in the household. This income amount would be adjusted in future years to reflect any increases in the Consumer Price Index;
- 2) The bill increases the EITC tax credit limit by \$100 million;
- 3) The bill adds an escalator to the EITC program’s tax credit limit. For any year beginning July 1, 2019, if the aggregate value of all credits awarded during the prior fiscal year equals at least 90 percent (90%) of the credit cap available for that year, the credit cap for the next fiscal year shall be increased by ten percent (10%) over the credit cap amount established for the prior year.

The tax credit value would not change and equals 75 percent (75%) of the total donations made to qualified scholarship granting organizations during the taxable year. If the donor commits to two (2) consecutive annual contributions, then the tax credit will be worth 90 percent (90%).¹

The present fiscal analysis reports the fiscal impact on state and local taxpayers and school districts under two scenarios. Estimates are reported under the current Basic Education Funding (BEF) scheme and under a system in which all state allocations are based on student enrollment. The current system of school funding features a strong hold-harmless rule where school districts are guaranteed a level of funding based on their enrollments in school year 2014-15.

Total state funds proposed in the Governor’s FY 2021 budget for Pennsylvania public schools are \$12.8 billion, or about \$7,500 per ADM (average daily membership—the enrollment count used by the state). BEF comprises over half of total state funding. The proposed amount for 2020-21 BEF formula funding is \$6.9 billion, or \$4,000 per ADM. The governor proposed that 12 percent of this amount, or \$799 million (\$465 per ADM), be distributed on a student-weighted basis. Thus, on average, when a student leaves a public school district to participate in the EITC program, about \$7,000 will remain with the district while \$465 reverts to the state.

Under a system where state funds are allocated on a student basis, state funds would be transferred back to the state if enrollment decreases. The analysis assumes districts would continue to retain all or most local and federal revenue.

Switchers represent an important factor in the analysis. The switcher rate is the percentage of scholarship students who would enroll in public schools without financial assistance from the EITC. The analysis considers switcher rates ranging from 60 percent to 90 percent.

Finally, the present fiscal analysis assumes that the credit cap will be reached. It reports estimates for only the proposed \$100 million expansion of the EITC, not for the program as a whole. It also assumes an average scholarship amount of \$2,000 per student.²

FISCAL EXPLANATION: Under this proposal, the state will have an estimated net cost worth between \$318 million and \$427 million. School districts will incur a positive estimated net fiscal impact worth between \$584 million and \$875

million. There will be no impact on local property taxes. The net combined impact would be positive, between an estimated **\$266 million and \$449 million (up to \$8,000 per scholarship)**.

Under fair state funding, the proposal would have a positive estimated net fiscal impact worth between \$150 million and \$275 million on the state and a positive estimated net fiscal impact for school districts worth between \$116 million and \$174 million. There will be no impact on local property taxes. The net combined impact would be positive, worth between **\$266 million and \$449 million, or up to \$8,000 per scholarship**.

Assuming an average award amount of \$2,000, the expansion bill would fund an additional 55,556 scholarships for students.³ Sixty percent and 90 percent switcher rates imply that among scholarship students, about 33,000 and 50,000 students, respectively, would be “switchers” from public schools.⁴

State impact: Tax credit disbursements by the state would equal up to \$100 million (the maximum amount of additional credits under this expansion bill above the current program limit). School districts would also retain an estimated \$218 million to \$327 million in state funding. This reflects a portion of BEF formula funding distributed on a student basis that would be transferred back to the state, between \$16 million and \$23 million. The state would incur an estimated net cost worth between **\$318 million and \$427 million**.

Under fair state funding, \$100 million tax credit disbursements would be offset by between \$250 million and \$375 million in funds transferred back to the state, resulting in a net positive state impact worth between \$150 million and \$275 million in savings.

Impact on local property taxes: There will likely be no impact on property taxes, at least in the short run, because they are set locally and independent of enrollment. In the long run, districts that experience significant enrollment change may choose to adjust property tax rates.

School district impact: Local public school districts would retain \$218 million to \$327 million in state funding. They would also have \$366 million to \$549 million in variable cost burden relief for students who would have enrolled in public schools without scholarships.⁵ Thus, there will be a net positive local impact of **\$583 million to \$875 million**.⁶

Under fair state funding, between \$250 million and \$375 million would be transferred back to the state after scholarship students leave, resulting in a net positive local impact estimated between **\$116 million and \$174 million**.⁷

Break-even switcher rate: Switcher is defined as a student who would otherwise enroll in a district school if the tax-credit scholarship program is not in place as opposed to enrolling in private school, home school, or other non-public school settings. Switchers represent fiscal savings for the state and district schools. Under the current funding system for public schools, there is no break-even point for the state. Under fair funding, for the program to be fiscally neutral to the state, just 24 percent of scholarship students would need to be switchers.

DATA SOURCES: Pennsylvania Department of Education; National Center for Education Statistics (U.S. Department of Education); U.S. Census Bureau, American Community Survey; EdChoice program data

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FISCAL SUMMARY

Summary of estimated fiscal impacts of Pennsylvania HB 800, School Year 2021-22

	Current BEF funding		Fair funding	
	60 percent switcher rate	90 percent switcher rate	60 percent switcher rate	90 percent switcher rate
Estimated total K-12 public and private school children	1,926,329	1,926,329	1,926,329	1,926,329
Total number of students in Pennsylvania eligible for tax-credit scholarships	1,281,191	1,281,191	1,281,191	1,281,191
% of Pennsylvania Households with Annual Income less than threshold for 3-person HH (\$110,608 FY 2021)	66.5%	66.5%	66.5%	66.5%
Total average cost per student for Pennsylvania K-12 public schools	\$17,582	\$17,582	\$17,582	\$17,582
Average cost of tax credit disbursements	\$1,800	\$1,800	\$1,800	\$1,800
Estimated average scholarship amount	\$2,000	\$2,000	\$2,000	\$2,000
Number of scholarships funded	55,556	55,556	55,556	55,556
Estimated number of scholarship students who would be switchers	33,333	50,000	33,333	50,000
Increase in state tax credit disbursements for EITC program expansion	(\$100,000,000)	(\$100,000,000)	(\$100,000,000)	(\$100,000,000)
State funds retained by school districts for students leaving public school districts via EITC	(\$233,333,333)	(\$350,000,000)	\$0	\$0
Funds transferred back to state for students leaving public school districts via EITC	\$15,501,353	\$23,252,029	\$250,000,000	\$375,000,000
Net State Impact	(\$317,831,981)	(\$426,747,971)	\$150,000,000	\$275,000,000
Net State Impact Per Scholarship	(\$5,721)	(\$7,681)	\$2,700	\$4,950
State funds retained by districts for scholarship students	\$233,333,333	\$350,000,000	\$0	\$0
BEF student-weighted formula funds transferred back to state	(\$15,501,353)	(\$23,252,029)	(\$250,000,000)	(\$375,000,000)
Estimated state funding retained by school districts (transferred back to state) for students leaving public school districts via EITC	\$217,831,981	\$326,747,971	(\$250,000,000)	(\$375,000,000)
Est. average variable educational cost per student	\$10,973	\$10,973	\$10,973	\$10,973
Total cost burden relief to school districts for students leaving public school districts via EITC	\$365,761,014	\$548,641,521	\$365,761,014	\$548,641,521
Net School District Impact	\$583,592,995	\$875,389,492	\$115,761,014	\$173,641,521
Net School District Impact Per Scholarship	\$10,505	\$15,757	\$2,084	\$3,126
Combined net state, local taxpayer, and school district impact	\$265,761,014	\$448,641,521	\$265,761,014	\$448,641,521
Combined net state, local taxpayer, and school district impact per scholarship	\$4,784	\$8,076	\$4,784	\$8,076
Break-Even Switcher Rate (State)	No break-even	No break-even	24%	24%

Notes: () denotes a decrease/negative value

Sources: Author's calculations; Pennsylvania Department of Education; U.S. Census Bureau; National Center for Education Statistics, U.S. Dept. of Education

¹ Based on conversations with staff at the Commonwealth Foundation who are familiar with the EITC program, 95 percent of donors in 2019 committed to two-year donations.

² The average scholarship award for the EITC in FY 2018 was \$1,816. Experience of tax-credit program expansion in other states, such as Florida, suggests that the average scholarship amount increases, as well as the number of students participating in the program. Thus, the analysis assumes \$2,000 average scholarship amount.

³ Under the proposed expansion, an additional \$100.0 million in tax credits would generate a maximum \$133.3 million in donations to scholarship organizations (assuming all tax credits are disbursed at 75 cents per dollar donated). Donors who commit to two years of donations may receive tax credits worth 90 cents per dollar donated. Given that 95 percent of donors during FY 2018 committed to donations for two years, the present analysis assumes a 90 percent tax credit rate which would generate an additional \$111.1 million in donations under the proposed expansion.

⁴ Random assignment studies of private school voucher programs report that, on average, between 84 percent to 90 percent of students who apply to oversubscribed programs and lose the lottery enroll in public schools. The programs analyzed in these studies target low-income families (typically households with income below 185 percent of the federal poverty level, which is lower than the eligibility threshold for the EITC). Thus, switcher rates for the EITC will likely be lower than switcher rates implied by these studies. Please note that this assumption is also in line with Costrell (2010), who showed that the switcher rate for the Milwaukee Parental Choice Program was 90 percent.

Martin F. Lueken (forthcoming), *The Fiscal Impact of K-12 Educational Choice: Using Random Assignment Studies of Private School Choice Programs to Infer Student Switcher Rates*, *Journal of School Choice*, published online March 2020 at: <https://doi.org/10.1080/15582159.2020.1735863>

Costrell, R. M. (2010). *The Fiscal Impact of the Milwaukee Parental Choice Program: 2010-2011 Update and Policy Options*. SCDP Milwaukee Evaluation. Report# 22. *School Choice Demonstration Project, University of Arkansas*.

⁵ Based on data from the National Center for Education Statistics at the U.S. Department of Education, we estimate that 62 percent of total costs are variable. This estimate is based on expenditures for Instruction, Student Support Services, and Instruction Support Services and excludes all other costs such as capital, debt services, food services, and transportation. Applying this percentage to \$17,582 in total expenditures per student yields estimated average variable costs per student of \$10,973.

Two studies on education costs suggest that variable costs are even higher than what is estimated in this fiscal note (Scafidi, 2012; Bifulco & Rebeck, 2014). Thus, fiscal benefits for Pennsylvania public school districts from expanding the EITC and OSTC programs will likely be higher.

Benjamin Scafidi (2012), *The Fiscal Effects of School Choice Programs on Public School Districts*, *Friedman Foundation for Educational Choice*, retrieved from EdChoice website: <https://www.edchoice.org/research/the-fiscal-effects-of-school-choice-programs-on-publicschool-districts>

Robert Bifulco and Randall Reback (2014), *Fiscal Impacts of Charter Schools: Lessons from New York*, *Education Finance and Policy* 9(1), pp. 86–107, http://dx.doi.org/10.1162/EDFP_a_00121

⁶ To be clear, this \$875 million net fiscal benefit associated with a 90 percent switcher rate includes \$549 million reduction in cumulative school variable cost burden for 50,000 additional students estimated to switch from public schools to private schools. It is not a direct reduction in school expenditures. The public schools will still have to make decisions to reduce costs as enrollment declines.

⁷ Under fair funding, this \$174 million net fiscal benefit associated with a 90 percent switcher rate would represent a \$549 million reduction in cumulative school variable cost burden, which would significantly outweigh the \$375 million in funds transferred back to the state for 50,000 additional students estimated to switch from public schools to private schools. It is not a direct reduction in school expenditures. The public schools will still have to make decisions to cut costs as enrollment declines. However, they now have \$549 million in available cost burden relief from which to find at least \$375 million in spending reductions to match the state funds transfer.