Memorandum – October 8, 2001

To: Whom it may concern
From: Joseph L. Bast, president
The Heartland Institute

Re: Reply to OLS Study of Proposed NJ Tuition Tax Credits

The New Jersey Office of Legislative Services (OLS) recently released a fiscal analysis of two pieces of pending legislation, the Parental Control and Involvement Act (A 3476) and the Educational Options Act (A 3475).

Last April, The Heartland Institute published my fiscal analysis of the same bills. While the OLS study does not mention the Heartland study, differences between my analysis and the OLS study were highlighted in a news release issued on October 2 by two state senators opposed to the bills.

My analysis concluded that adoption of the two bills would lead 7 percent of students now enrolled in public schools to switch to private schools. State tax revenues would fall by $585 million, but the fall in public school enrollment would enable public schools to reduce spending by over $1 billion, for net annual savings to taxpayers of $480 million.

The tax credit opponents claim that the OLS study proves “the $480 million savings [is] completely illusionary” and “$116 million would have to be made up by local property taxpayers.” In the rest of this memo, I explain why these assertions are false. Before proceeding, though, the record should be set straight on three matters:

- Then-Jersey City Mayor Bret Schundler asked me to conduct a study of early drafts of the tax credit bills, and he attended the news conference last April at which the results of the study were announced. But he did not dictate my findings or unduly influence my analysis. Indeed, both of us were surprised by what the “number crunching” revealed.

- Neither I nor The Heartland Institute was paid or promised payment for producing the report. It was funded from general operating gifts from Heartland’s 1,300 donors and members and underwent peer review before publication.

- David Rosen, author of the OLS study, consulted with me frequently as he worked on his analysis, and he deliberately organized his report in a way that would allow the two studies to be compared. I respect Rosen’s professionalism and the soundness of his work, even if we disagree on some assumptions and conclusions.
I am not an “advocate” of tax credits. The focus of my professional work has been finding ways to hold schools accountable to parents for showing acceptable results. Tax credits, in my opinion, represent only a small step in this direction.

Why the Studies Differ

The OLS analysis concluded that the two bills would cause just 1.4 percent of students to switch and would reduce state tax revenues by $315 million. State aid to local school districts would fall by $116 million, reducing the net cost to the state to $199 million. These conclusions differ from those of The Heartland Institute study for three reasons:

1. **OLS assumes much lower rates of charitable giving in response to EOA.**

   OLS and Heartland made very similar assumptions about the rate at which taxpayers would claim tax credits under PCIA, and consequently have similar estimates of the cost to the state treasury ($223 million versus $200 million). But our assumptions regarding EOA are very different:

   1. Heartland estimated that 10 percent of the state’s wealthiest 1 percent would donate enough to qualify for the entire $10,000 credit; OLS estimated only 3 - 6 percent would.

   2. Heartland estimated 10 percent of the state’s 3.6 million households who file federal tax returns would contribute an average of $1,000; OLS estimated only 3 - 6 percent of the 1.173 million taxpayers who itemized deductions on their federal tax returns would contribute an average of $1,000.

   3. Heartland estimated that 50 percent of NJ corporations would contribute the maximum amount allowed by the act (10 percent of corporate income tax liability); OLS estimated that the average corporation would contribute only 10 - 20 percent of that amount.

   These different assumptions mean Heartland’s estimate of the amount of money available for scholarships is about three times OLS’s estimate. Scholarship funding determines the reduction in private school tuition, and consequently how many students would switch from public to private schools: Heartland estimated 83,683 students would switch; OLS estimated 18,348.

**Who is right?** Both studies admit to making plausible but essentially arbitrary assumptions. I believe OLS’s assumptions are too low for several reasons. They rely heavily on participation levels reported for Arizona’s tax credit plan, which is too new (adopted in 1997) and too modest (tax credits are capped at $500) to give us much insight into the likely response to much more generous tax credits (capped at $10,000). Moreover, Arizona’s lower personal income and population density make choosing private schools less attractive than in New Jersey.
I don’t believe it is correct to assume that the number of taxpayers who itemize deductions would remain unchanged in the face of new tax credits for a very popular cause. I also believe it is realistic to forecast New Jersey’s corporations using the tax credit plan to earmark 5 percent of their corporate income taxes to scholarship funds, rather than the 1 - 2 percent forecast by OLS.

2. OLS measured only the state’s share of avoided costs, whereas Heartland estimated the savings to taxpayers.

Heartland multiplied the number of students expected to transfer (83,683) by current per-pupil spending and estimated that taxpayers would save about $1.065 billion a year. The OLS, in contrast, multiplied the number of students it expected to transfer (18,348) by per-student state school aid and estimated the state would save $116 million.

Comparing OLS’s estimate of cost avoidance by the state to Heartland’s estimate of savings by taxpayers, as is done in the news release opposing tax credits, is comparing apples and oranges. The author of the news release is apparently trying to make hay out of three typos in the 37-page Heartland study where the savings to taxpayers are incorrectly called a savings “to the state treasury,” but the analysis makes the difference clear, and elsewhere in the study they are correctly called savings to taxpayers.

So how much would the state treasury save? Combining Heartland’s estimate of the number of students expected to switch to private schools with OLS’s methodology for calculating savings to the state generates a new estimate of cost avoidance by the state: $530.2 million. Heartland forecasts that the tax credits would reduce state tax revenues by $584.7 million, so the state treasury would see a net loss of $54.5 million, about a fourth as large as OLS’s estimate.

Property tax relief, not an increase: If per-pupil spending by public schools remains unchanged, total spending would fall by $1.065 billion. If $530.2 million of that amount takes the form of reduced state spending, then the balance, about $470 million, would take the form of lower spending by local governments, and could lead to property tax relief in the same amount.

3. OLS assumes there is no reduction of spending when a student leaves a school.

Heartland assumed public school spending would be reduced by the number of students switching times current per-pupil spending. The OLS assumes so few students will switch, and they will be so widely distributed across schools, that local school districts will be unable to cut spending. The author of the news release concludes local governments will have to make up for a $116 million decline in state aid. But this reasoning is flawed.

If the number of students who switch to private schools is 83,683 rather than 18,348, even OLS would agree that spending reductions would be possible. If OLS’s assumptions about how much will be raised for scholarships are too pessimistic, as I argue in point (1) above, then the claim that public spending cannot be reduced is invalid.
Second, enrollment losses are unlikely to be evenly distributed across all schools, as OLS assumes, but instead would be concentrated on a relatively small number of underperforming schools. For example, if half of all students who switch come from the 20 percent of schools in the Abbott districts that are arguably the worst, each school would lose about 433 students . . . a number large enough to permit staff reductions and even facility closures and consolidation.

Finally, the claim that education spending cannot be reduced in step with enrollment changes is self-serving and wrong. Private schools, indeed all private businesses, constantly respond to marginal changes in demand for their services by cutting back on expenses. Public school systems, because of their large sizes, have opportunities to shift or consolidate resources among schools, reduce staff through attrition, sell underutilized assets, and so on. The marginal cost of educating one more (or one fewer) student may differ from the average cost, but budgeting on a per-pupil basis is superior to any alternative. It is foolish to assert that 18,000, or even 80, students are currently being educated at zero cost.

**Conclusion**

I stand by all of the conclusions of the Heartland policy study on tuition tax credits for New Jersey. *Far from “illusionary,” $480 million is a realistic and even conservative estimate of savings to New Jersey taxpayers. Rather than lead to an increase in local property taxes of $116 million, the tax credits should allow property taxes to fall by $470 million.*

The OLS study is a fine piece of work, except that it underestimates the likely amount of dollars contributed to scholarship funds. This error explains why OLS predicts too few students would switch to private schools to allow public schools to reduce their spending, a prediction which, in turn, forms the basis of other charges contained in the anti-tax credit news release.

I appreciated being contacted by Mr. Rosen as he worked on the OLS study, and I further appreciate having the typos in the Heartland study pointed out so they could be corrected. The full text of the Heartland study, along with more information about tax credits, can be found on The Heartland Institute’s Web site at www.heartland.org. Or contact me at 312/377-4000 or by email at jbast@heartland.org.

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