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Universal ESA's:

Where We Are and Where We Are Going

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About the Authors

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CSI is committed to independent, in-depth research that examines the impacts of policies, initiatives, and proposed laws so that Arizonans are educated and informed on issues impacting their lives. CSI's commitment to institutional independence is rooted in the individual independence of our researchers, economists, and fellows. At the core of CSI's mission is a belief in the power of the free enterprise system. Our work explores ideas that protect and promote jobs and the economy, and the CSI team and fellows take part in this pursuit with academic freedom. Our team's work is informed by data-driven research and evidence. The views and opinions of fellows do not reflect the institutional views of CSI. CSI operates independently of any political party and does not take positions.

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Summary and Key Findings

Arizona's Empowerment Scholarship Accounts have been at the center of an education funding discussion in 2023. After passing a law in mid-2022 opening enrollment in the state's Empowerment Scholarship Account program to all students, participation grew quickly – from about 12,000 students to over 30,000 by the end of 2022, and reaching 56,000 students by mid-2023. In her inaugural State of the State address, Arizona's new Governor Katie Hobbs stated she believed that ESA eligibility expansion and increased participation would "bankrupt the state" and cost "an estimated $1.5 billion over the next 10 years".

On the other hand, a CSI analysis released in January found that enrollment in the state's public schools had declined between 30,000 and 70,000 students relative to pre-pandemic projections. These enrollment declines generate substantial state funding savings and are consistent with a nationwide shift in preferences by parents and children for education[i]. Between 2019 and 2022, despite unprecedented investment in Arizona's public K-12 public-schools[1], parents have shown increased interest in alternatives to their assigned district school. Arizona's existing school choice model gave parents flexibility to find an option that helped their child continue to learn during the pandemic-era classroom disruptions.

CSI's analysis indicates that the rapid growth in ESA participation during the first year following universal eligibility can be explained in part by the large base of new private- and home-schooled students who left their district schools during 2020 and have not returned.

As more education options become available, the ESA program will likely continue to see more use commensurate with continued declines in district school enrollment.

KEY FINDINGS

- **44,007:** Number of students (est. as of May 15) newly enrolled in the ESA program under universal eligibility. At least 56,134 Arizona students now receive an ESA, and more students are added to this count weekly as the Department of Education updates their reporting.[ii]
- **33,316:** Number of students that have left public *district* schools since 2019. The students could have enrolled in public charter schools, private or online schools, started homeschooling, or could also no longer live in the state. Of note, **current enrollment in Arizona public district and charter schools combined is over 80,000 students below pre-pandemic projections.**
- **$639 million:** Total statewide equalization formula savings due to less-than-expected public school enrollment growth since the pandemic. According to JLBC, the state spends $7,937 on direct per-pupil formula funding for every Arizona public school student. On average, about 62% of this comes directly from the state General Fund.
- **$400 million:** Total estimated annual cost of the expanded ESA program. Empowerment Scholarship Accounts provide students with 90% of the formula funding they would have received if enrolled in a public school. As of early 2023, the average scholarship was $10,004.
- The median income of families in the ESA program as of December 31, 2022 is about $60,600. The median income of families in Arizona with at least one child is $69,700. Meaning, on average, **the typical family receiving an ESA is less well-off than the median Arizona family.**

[1] According to JLBC, total K-12 funding in Arizona increased 50% over the eight-year period ending in FY 2023.

This report provides a current consideration of how the program might further change and grow in the coming year. CSI's original report, investigating the initial impact of the expansion during its first quarter, is available online here.

Long Term & Pandemic-Era K-12 Enrollment Trends in Arizona

A 2007 Auditor General sunset review of the then-recently created School Facilities Board noted that public school enrollment in Arizona had grown by 19% in the first seven years of the 21st century - or about 2.5%/year.[iii] Long term projections at the time anticipated growth to continue at a pace of about 1.9% /year, and the School Facilities Board believed there would be 1.2 million district public school students alone in Arizona by 2017. According to JLBC, actual district school enrollment in 2017 was less than 916,000; across district and charter schools combined, total public school enrollment had climbed to just 1.1 million (a shortfall of 100,000-200,000 students relative mid-2000's projections).

Since 2020, this trend has only accelerated; during the 2020-21 school years, growth declined the most on record. Following a minor recovery last year, public school enrollment growth has slowed again.

Forecasts made by JLBC take population growth and previous trends into account, and population growth has largely proceeded as expected (slowing following the Great Recession but accelerating again after the pandemic) – so the students Arizona expected to see in public schools did not simply "disappear" from the state. Instead, data suggests that in 2020,many parents began to rethink how their children were being educated, and more students have since taken other education avenues (including home- and private-schooling). Arizona's total K-12 population is largely following its expected pre-pandemic course, but fewer kids are enrolling in public schools and more in private alternatives. The last year of available data (2021) showed that STO scholarships increased 7% and private school enrollment increased over 3%.

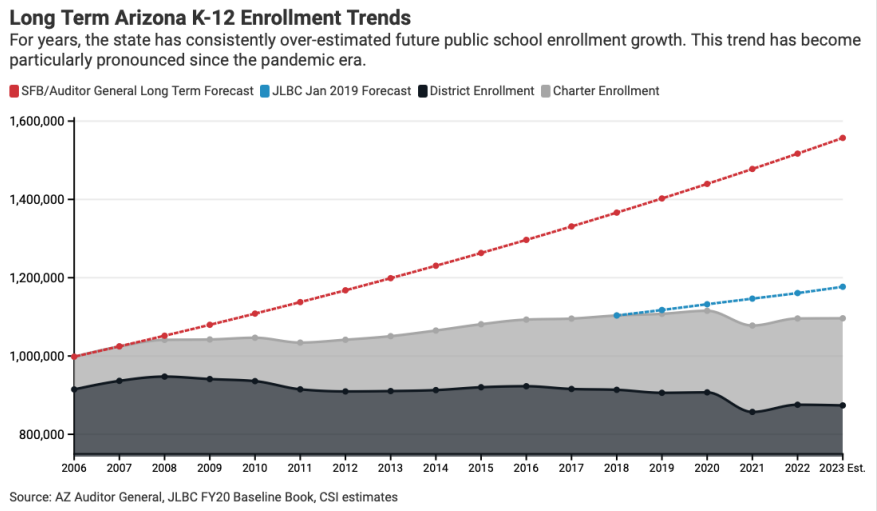

Figure 1

ESA Program Background

The Empowerment Scholarship Account program was created in 2012 to provide eligible participants with 90% of the money their district or charter school would have received in basic formula funding had they enrolled in public school. Rather than going directly to the district or charter school, the funds are placed in a financial account that the parent or beneficiary can access to directly pay eligible education costs. Pursuant to A.R.S. § 15-2402, allowable expenses include tuition, textbooks and classroom supplies, tutoring, and other similar goods and services. ESA programs cover a much broader range of educational choices than simply private school tuition, and traditionally

a disproportionate share of program beneficiaries have had learning disabilities or other specialized learning needs. Because of this, per-student funding has historically been much higher for the ESA program than in the much larger public school system (in 2022, for example, the program gave an average annual award of over $15,500).

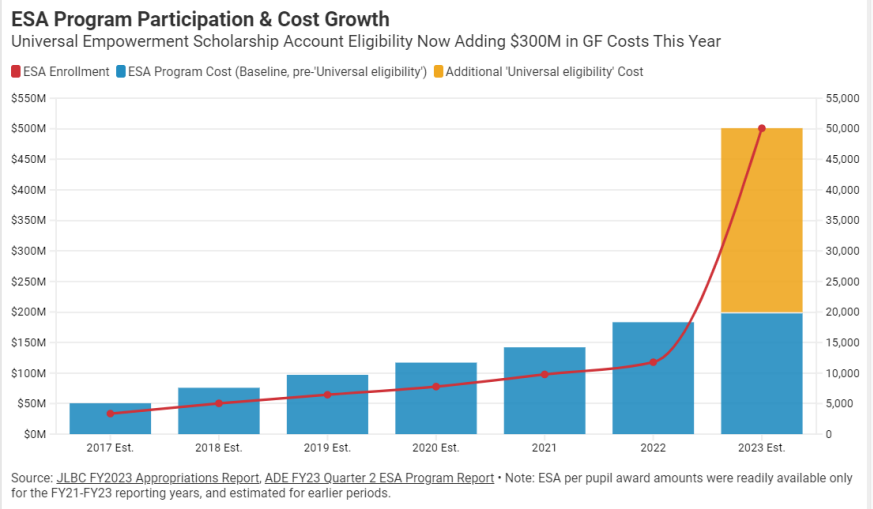

Figure 2

Currently, the ESA program has more than 56,000 enrolled students – a dramatic increase from about 12,000 students in 2022[iv]. This increase in enrollment is due to universal eligibility and adds approximately $400 million in General Fund costs this year above the estimated $150-200 million CSI estimates the program would have cost without the new universal eligibility category expansion[v].

The ESA program is fully funded by the state's General Fund and is administrated through the Department of Education. While the legislature estimates funding needs for the individual programs in developing the annual state budget appropriations, it's not necessary that these *individual* estimates be correct – surpluses in one line can and regularly are used to cover shortfalls in other areas. This is routine, and it would not be unusual if surpluses from enrollment declines were used to cover, for example, ESA program shortfalls. Further, because public district and public charter schools may run programs that serve non-enrolled students (including ESA recipients, who pay for the services with their ESA funds), the state's public schools are able to benefit from some of the expanded ESA funding.

To access funds in the account, beneficiaries must submit auditable invoices that establish both the amount and eligible nature of the expense. Funds are disbursed quarterly to eligible students via an intermediary financial services account, for a period of one year. Participation must be renewed (and eligibility re-established) annually, and unused funds roll over at the end of each disbursement period. Once a student graduates or otherwise becomes ineligible, they no longer receive new funding but may continue to use existing funding for eligible expenses. A student also cannot receive both an STO (School Tuition Organization) scholarship and an ESA; however, students in the state's STO program (a private scholarship option supported by state tax credit-eligible donations) can receive multiple STO scholarships.

Where is the ESA program headed?

Before universal expansion, students were (generally) required to attend a public school to qualify for the ESA program and/or meet specific eligibility criteria. Since universal expansion, previous public-school attendance is no longer required, and a student need not meet any specific eligibility criteria beyond age and Arizona residency; over 35,000 students have enrolled in the ESA program under this new category. Another approximately 46,000 private school students were likely already receiving an STO scholarship prior to enactment of universal ESA expansion and are therefore ineligible for Empowerment Scholarships[2] , and approximately 12,000 students were already receiving an ESA under existing eligibility

[2] While there is no requirement that School Tuition Organizations or private schools report the aggregate number of students receiving STO scholarships statewide, the NCES conducts a biennial survey of enrollment in certified private schools in Arizona. Based on this data and the total number of scholarships issued, CSI estimates approximately 2.12 scholarships/student in the STO program.

categories[vi]. Based on Census data on the number of K-12 aged students in Arizona, public district and charter school enrollment trends, and private school students already receiving some form of state support (existing ESA and STO scholarships), we believe there were approximately 82,693 Arizona students eligible for an ESA scholarship during the current (2022-23) school year. Given 56,134 were participating in the ESA program as of May 15, **over 26,000 private and homeschooled students remain eligible but not enrolled.** At an average annual award amount of $7,143, this is a potential additional program cost of $190 million that policymakers should consider allocating to the program in anticipation of that participation.

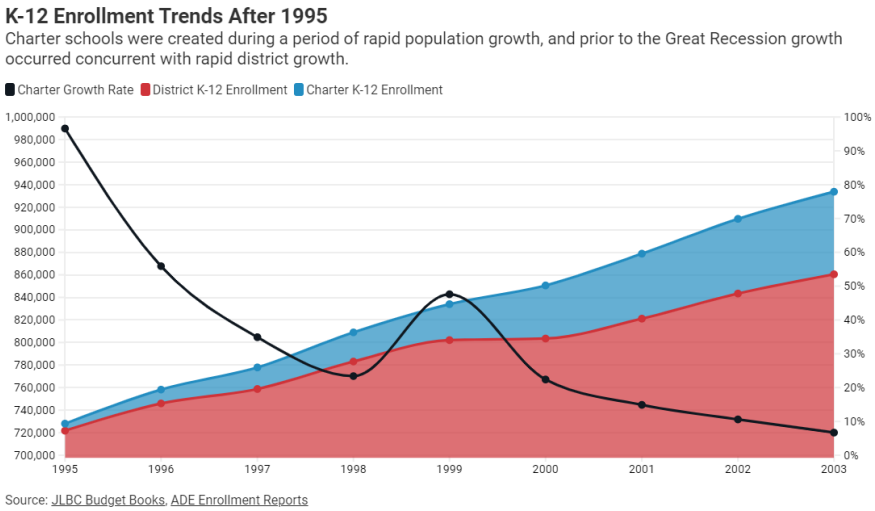

Figure 3

Still, this only addresses the eligible population today; open is the question of how this program might grow over the next decade, and what that will mean for statewide K-12 funding costs (after accounting for shifts away from traditional district and charter schools). One historical parallel was the growth in the state's charter system after its creation in 1995. Following creation, the charter system grew rapidly – taking about seven years to reach a steady-state level of 57,000 students in 2001 at an average annual growth rate of nearly 50%. However, this occurred during a period of rapid growth in Arizona, both generally and in its school-aged population. Average annual district enrollment growth during the same period was over 2%. Additionally, charter growth was constrained by the need to establish new state-licensed facilities, while the ESA program can take advantage of both existing private school infrastructure, and parental options to homeschool, enroll in an online program, or otherwise use an alternative model to the traditional K-12 institution. Demographic change in the United States and Arizona requires ESA growth to come from enrollment shifts of existing student populations (rather than the natural growth that fueled both rapid charter and district growth in the 2000's).

After the Great Recession, a combination of declining birth rates and slowing migration between states ended Arizona's prior period of rapid K-12 enrollment growth. However, the state's charter schools were still able to grow at an average rate of over 7% during the 12 years between the 2008 Great Recession and the COVID pandemic; this growth now came at the expense of (rather than parallel to) the state's district schools, whose enrollment declined at an average annual rate of -0.3% over the same period. By 2020, charter school enrollment had grown from 8% to nearly 20% of all public school students. This experience likely provides better insight into the prospects of both the state's ESA program and its traditional public school options given that we face similar trends today.

To forecast program growth over the next five years, CSI makes the following high-level assumptions:

- The substantial flexibility afforded ESA participants in terms of educational options allows for rapid program adoption relative to 1995's charter rollout. CSI assumes that by the end of the May-August enrollment cycle for the 2023-24 school year, all the state's eligible private- & home-school population would be receiving either an ESA or an STO (given universal eligibility). This is

an upper-bound assumption – if actual utilization rates are lower, enrollment numbers and costs would be lower than contemplated here, but there would be no corresponding increase in public K-12 enrollment or costs.

- Future program growth will need to come from a combination of natural 5–18-year-old population growth (assumed 0.5%/year), and a movement of students away from the district and charter system and into the private space.
- The 12-year period between the Great Recession and the pandemic provides a template for what a gradual transition from public district schools to alternative options might look like. During this period, district enrollment declined at an annual rate of -0.31%.
- The 2-year period following the COVID pandemic (calendar 2021-2022) provides our first insight into how charter school enrollment might respond to the combination of expanded ESA eligibility and changing parent preferences. While still growing, charter growth has slowed to 0.43%/year.8

Under this set of assumptions, **CSI expects that the state will have 124,000 ESA program participants by the 2027-28 school year,** at a total program cost of $900 million (FY 2023 formula dollar amounts, and up from approximately $550 million today). However, over the same period, **total public school enrollment will decline from 1,096,400 students to 1,087,800 students.** Systemwide, the number of formula funded students will grow at a combined annual rate of 1.1% over the next five years. For context, over the 12-year period prior to the pandemic, the equivalent annual growth rate in public K-12 formula funded students was 0.7%, while during the 10-years prior to the Great Recession enrollment growth was 3.2%/year.

Strikingly, however, this average annual rate is almost entirely attributable to catch-up growth as existing K-12 students who are currently not formula funded or General Fund supported (via STO tax credits) are brought into state funding via universal ESA eligibility. After 2024, K-12 enrollment growth by assumption becomes purely a function in the growth rate of Arizona's K-12 eligible population. This is a stark departure from historical norms where the public K-12 charge was a function of both the population aged 5-18, and the number of parents who chose traditional (district) public schools. Arizona began this departure in 1995 with its adoption of a charter school system, but the private- and home-schooled population remained outside the state funding system. **When this population (outside the public funding formula) grew rapidly during and after 2020, that created an unexpected statewide revenue windfall.** Universal ESA expansion effectively reinvests that windfall back into the education of K-12 students over the next few years. After that reinvestment, public-school formula funding commitments grow at the rate of school-aged population growth; the era of formula funding costs growing *slower* than population is over.

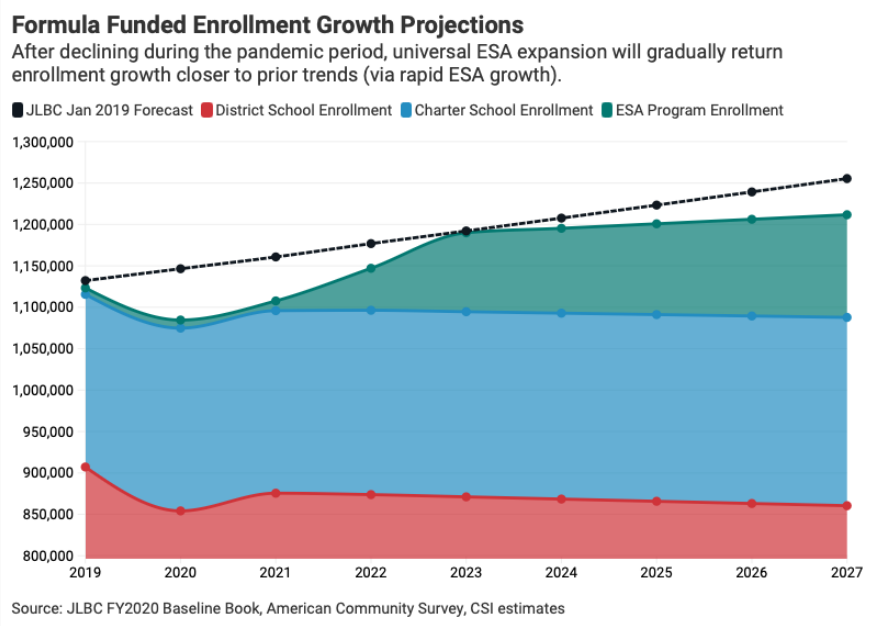

Figure 4

CSI Analysis

BUDGET IMPACT

In 2019, public-school enrollment peaked at 1,115,600 kids. The following year (2020), enrollment fell to 1,077,800 kids, and even today there are only about 1,096,400 kids enrolled in Arizona district and charter public-schools. Had enrollment remained at the pre-pandemic levels, K-12 formula funding would have been higher; **the cumulative savings over the past three years due to this enrollment decline ("missing kids") is over $550 million.**

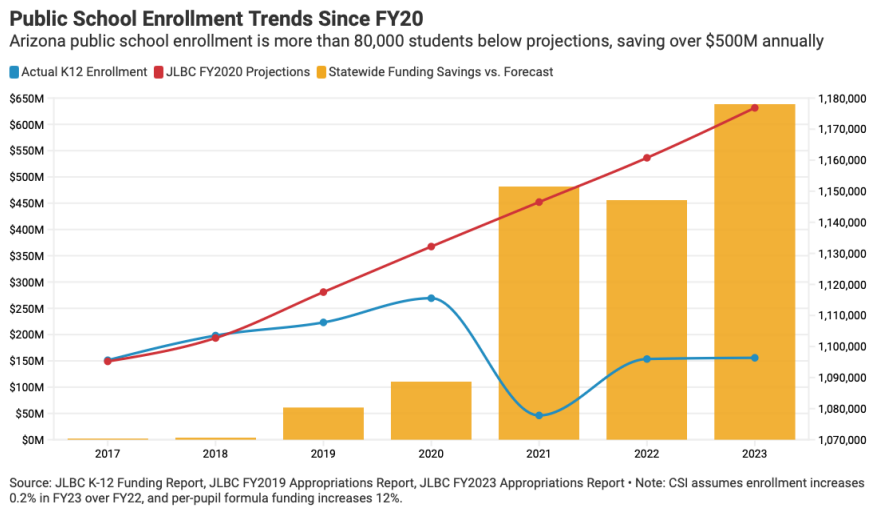

Figure 5

But simply comparing enrollment to pre-pandemic peaks does not capture the whole story. During the pandemic, migration into Arizona surged – the state added about 100,000 new residents in 2020 alone. Arizona's K-12 school aged population is estimated to have increased by at least 30,000 kids since 2019. Had those new students enrolled in public schools and the state's K-12 formula funding commitments been consistent with pre-pandemic projections, **the cumulative cost over the past three years would have been even higher $1.6 billion,** or about $639 million annually[3].

Above we introduce the concept of separately considering the savings from pandemic-era "missing kids" – school-aged children actively exiting the legacy public school system during 2020 – and the savings from slower-than-expected growth as public school enrollment has continued to lag the state's official estimates every year since. The cumulative impact of the latter is stark and understanding this trend is key to understanding what is going on in the ESA program today (both in terms of student growth and budget implications).

The state spends $7,937 on direct per-pupil formula funding for every public school student in Arizona, and about 62% of this comes directly from the state General Fund[vii]. While enrollment estimates can change from year to year, this annual savings of about $639 million will only grow if public school enrollment continues to fall below previous trends as projected. For example, actual 2023 public school enrollment is on track to be about 10,000 students below budgeted levels and this

[3] Every year, state analysts make predictions about the growth in the state's fiscal commitments over the next 3+ years, including projecting K-12 public school enrollment. While it is relatively uncommon for public school enrollment to fall from year-to-year (like it did in 2020), it is relatively common for actual enrollment to fall below these projections. The gap after 2020 is much larger than it has been historically, though, due to rapid changes in enrollment trends during the pandemic. Enrollment declines result in less year-over-year spending ("actual savings"), while enrollment below-projections generates less-than-expected spending growth.

decline generates about **$50 million in General Fund savings just from new 2022 public school enrollment shortfalls**[viii]**.** Those savings can be used to offset the cost increases in growing programs, like the ESA program.

While declining public-school enrollment generates state budget savings, the new universal Empowerment Scholarship Account expansion has – as discussed above – effectively returned the state's K-12 formula funding obligations back to prior (population growth dependent) trends. This creates new state and General Fund spending commitments that will begin to offset the savings seen in recent years.

As of May, approximately 44,000 students are newly enrolled in the ESA program under universal eligibility, bringing total ESA enrollment to 56,134. The average scholarship award for these students was $10,004 as of the second quarter of fiscal year 2023 (which ended on December 31st, 2022). Considering the number of students enrolled and the average award, CSI estimates the total cost of the ESA programs universal eligibility expansion to be about $400 million. **Considering both increased ESA costs and decreased public school formula costs, the state is still realizing a net aggregate statewide education cost savings of about $200 million, relative to pre-pandemic enrollment assumptions.** However, to reiterate, given trends in universal ESA enrollments those "savings" will be consumed rapidly by the return of remaining "missing kids" to state funding via the ESA program.

Additionally, the ESA program – unlike traditional district public schools – is entirely General Fund-supported. On average, the state General Fund is responsible for about 62% of public formula funding costs; this ratio varies by school from a high of nearly 100% for charter schools, to a low of nearly 0% for certain property-rich "non-state aid" districts. Therefore, on average, *General Fund* savings from reduced public school enrollment will be less than the total statewide savings, while General Fund spending on the ESA program will equal the total statewide cost. Like charter school expansion, ESA expansion will have the effect of increasing the General Fund share of aggregate statewide K-12 funding. However – also like charter expansion – it will reduce local K-12 funding support, generating taxpayer (mostly property tax) savings.

After accounting for an assumed ~61% split between local and General Fund savings, the $244.6 million claw back in the FY 2023 budget, and the $33.4 million increase in ESA costs already budgeted for, the General Fund will still likely need supplemental funding of at least $250 million by the end of FY 2023 (the final budget agreement included approximately $275 million, for perspective). For perspective, current public school enrollment costs $8.7 billion statewide equalization formula funding at the per-pupil funding amount of $7,937. The total cost of the ESA program remains only about 8% of General Fund spending on education.

As the ESA program continues to grow CSI estimates that ESA enrollment will reach 124,000 students by the 2027-28 school year, bringing the total cost of the ESA program would increase to $885 million (FY 2023 per-pupil funding amounts). Although ESA program costs will increase as more families use it, public district and charter school enrollment is expected to continue falling - dropping to about 1.087 million students and decreasing the total statewide public school formula funding to $8.6 billion (constant FY 2023 per-pupil funding amounts, from about $8.7 billion this year). Aggregate K-12 funding (districts, charters, and ESA's combined) rises from $9.1 billion today to $9.5 billion in FY 2028 (a cumulative annual growth rate of only about 1%/year, again in constant 2023 dollars). Discretionary

increases above this level would impose additional costs but are not required by the legal baseline; policymakers must be more cautious now than in the past, though, because we are accustomed to a period of flat or declining formula-funded enrollment growth (which is likely now over).

Notably, were these 124,000 future ESA families to instead enroll in public district and charter schools, statewide K-12 expenditures would increase by approximately $100 million (since an ESA's value is statutorily limited to 90% of a student's funding formula equivalent). **While universal ESA expansion will increase statewide K-12 expenditures relative to their post-2020 baseline trends, it does so largely by returning state per-pupil funding commitments to their pre-pandemic trajectory.** Total expenditures remain below their public-school-funded alternative due to the 90% formula commitment.

ESA DEMOGRAPHICS

While the state may be saving money with the ESA program in the long term, it is interesting to see the demographics of the families that are enrolled in it. Because the ESA program does not require students to attend a public school prior to enrolling in the program, this scholarship may attract students from all schooling avenues. Before the ESA program expanded to universal eligibility, students not in public schools could rely only on their family income or some help from STO scholarships if they wanted to enroll in a private school, homeschool, or online school. This likely made it infeasible for many students to leave public school. Universal eligibility for the ESA program has become a critical tool for families seeking alternative education for their children. **CSI found that the median income of families in the ESA program as of December 31, 2022 is about $60,600.** For perspective, the median income of all Arizona households is $61,500 (2020 constant dollars)[ix]. However, the median income of families in Arizona with at least one child is $69,700 because, on average, families with children have a higher income[x]; this makes comparisons that do not account for this misleading (lower-income households tend to be young, single adults). **Meaning, on average, the typical family receiving an ESA is less well-off than the median Arizona family, conditional on having a school-aged child in the household.**

Because universal ESA eligibility and other school choice programs are intended to help families pay for a costly non-public K-12 school or curriculum they may otherwise struggle to afford, it is important to look at detailed demographic breakdowns to try and confirm that the program is expanding access rather than simply affirming existing choices by legacy families.

ESA Students by Median Income

Middle income families in Arizona are the disproportionate users of the ESA program.

Household Income Range	Median income of ESA families	% of ESA Students	% of Arizona Households With at least 1 child
$0-$34,999	$ 30,000	5%	23%
$35,000-$49,999	$ 40,797	21%	12%
$50,000-$74,999	$ 62,083	33%	17%
$75,000+	$ 98,866	41%	48%

Source: Arizona Dept of Education, American Community Survey 2020, National Center for Education Statistics

Figure 6

CSI was able to match where students receiving an ESA are in the state, by zip code, to the median income of families with at least one child in that zip code. About 9,500 students come from areas where the median income for families with at least 1 child is above $100,000 (roughly 19% of ESA recipients). CSI estimates that around 20,400 ESA students come from areas where the median income of families with at least one child is above the Arizona state median income for this demographic of $69,700.

The disproportionate users of the ESA program are middle income earners; both high income and low income are underrepresented showing that the middle-class families are getting the most use from universal expansion. Instead of middle- and lower-income families paying for the education of students from high income families, as some have suggested is happening with universal ESA's, the exact inverse is true. While more information is needed to determine how the ESA scholarships are being used by these students and families, it seems clear that the middle-income earning families are the programs greatest beneficiaries.

THE BOTTOM LINE

Given the data, Empowerment Scholarship Account enrollment growth following universal expansion makes sense in the context of the rapid enrollment shifts that occurred after 2020. This new population was likely not being served by the existing school choice programs. Once enrollment reaches 100,000-105,000 members over the next year, growth should moderate going forward. Expansion of eligibility for ESAs has so far benefitted mostly middle-class families, and the median income for ESA participants to-date is lower than the median family income.

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