

DEFINING THE EDUCATION MARKET: RECONSIDERING CHARTER SCHOOLS

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Several economists and education researchers have argued that current school choice programs fall far short of a true market in education. According to Frederick Hess (2004: 249), “Those who suggest that a smattering of charter schools, that a handful of school vouchers, or that the public choice provision of No Child Left Behind are sufficient to force systematic improvement are allowing their enthusiasm to get the best of them.” Similarly, in *School Choice Wars* (2001) John Merrifield wrote about the limits of current school choice “experiments” and the necessary criteria for a true market in education. And when Andrew Coulson (1999) examined the history of market education and detailed the five features of a true education market, he also noted that current choice programs do not meet market criteria. In short, there is a fairly sizable body of scholarship that recognizes that most programs advocated within our current school choice movement lack fundamental market mechanisms.

What Does the K-12 Education Industry Look Like?

Further, the for-profit education industry that currently exists is closely tied to the government monopoly provision of education services. Despite poor market conditions, the for-profit K-12 education industry continues to grow on the margins.

Most of the growth has been tied to government initiatives that increase funding for the private sector as well as public schools. As Michael Fletcher and Neil Irwin first argued in an August 16, 2001, *Washington Post* column, “President Bush says his education reform

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plan will empower parents and hold educators responsible for how students perform in school. But the bill also is certain to have another, less vaunted effect: to create a lode of new business for private educational firms.” The most recent K-12 industry growth has largely been pegged to the standardized testing industry and the No Child Left Behind Act. For example, the Education Industry Association (EIA), which is an 800-member professional organization for education entrepreneurs, has recently relocated to Washington, D.C., and appears to have substantially increased their lobbying efforts with the U.S. Department of Education and Congress. In addition, much of the EIA’s growth has been in segments supported by the No Child Left Behind Act, especially testing and assessment and private tutoring companies. Similarly, a new education trade newsletter, the *School Improvement Industry Weekly*, bills itself as “a Web-enabled newsletter for the marketplace created by No Child Left Behind” (www.siiwonline.com).

In other words, the for-profit education industry has experienced substantial growth not from individual consumers choosing education services but from government mandates that have directed more resources to the private-education sector.

And the government-education sector shows no signs of reducing government spending on education. At this point, the education industry appears justified in tying their business to direct increases in government spending. In a July 2004 study, the Cato Institute’s Neal McCluskey (2004: 1) notes that federal spending at more than 36 departments and organizations that run major education programs ballooned from about \$25 billion in 1965 (adjusted for inflation) to more than \$108 billion in 2002. This year, funding for the U.S. Department of Education is at an all-time high: \$56 billion, an increase of \$2.9 billion over last year and \$13.8 billion since Bush took office.

The president’s 2005 budget would raise education spending still further, to \$57.3 billion. Under No Child Left Behind, Title I aid has risen to \$12.4 billion. Title I spending has increased more during the first two years of the Bush administration than it did during all eight years of the Clinton administration.

The truth is that for-profit education companies often support the status quo and are lobbying for more government-funded education, not necessarily more market education. The for-profit sector embraces a government sector that will direct more money to private companies. Therefore, if the bottom line is free-market education, scholars need to further consider the implication of a for-profit education industry that has grown up around the existing government-education sector and how the industry’s investment in current

funding and governance processes potentially derails a true education market.

The Charter School Movement and the Growth of For-Profit Schools

It seems clear that when we talk about a true education market we are talking about a market for new schools that offer K-12 education and not the for-profit sector tinkering on the edges of government schools. Yet, the for-profit education industry has grown mostly at the margins. The one exception has been the significant for-profit and nonprofit investment and growth within the charter school movement.

Ironically, charter schools are the market reform that many free-market scholars agree are the most marginal and that meet the fewest market criteria. By most accounts of what an education marketplace should look like, charter schools have been viewed as a compromise, a diversion, or as generally lacking the components necessary for a true market in education.

As Merrifield (2001: 35) explains in *School Choice Wars*,

There is little hope that charter school legislation will capture the benefits of a competitive education industry, or even change the school system significantly. . . . Like other versions of choice that create few, if any, market conditions, charter schools could reduce the political feasibility of a competitive education industry. Though certainly an improvement over the status quo, charter schools are much more likely to be a major, perhaps permanent detour than a step in the right direction.

Similarly, Coulson (1999: 339) argues that while charter school advocates are on the right track, “they are playing with model trains when they could be harnessing locomotives.” Yet, charter schools have led to the greatest new capacity in for-profit and nonprofit K-12 schools. And that capacity is not unsubstantial.

How Do Charter Schools Meet Market Criteria

We can reexamine charter schools in light of three standard lists of criteria for a true market in education laid out by Merrifield, Coulson, and the Milton Friedman Foundation.

Merrifield (2001) argues that the following policies are essential for a free market in education:

1. State and local public funding of K-12 instruction must be entirely child-based so that parents' school choices exclusively decide each school's share of state and local government funding.
2. Each child's share of state and local K-12 instruction spending is the same, whether the child attends government-owned, private nonprofit, or private for-profit schools.
3. There must be no restrictions on private spending on K-12 instruction. Families must have the right to use private funds to help buy more instruction than public funds will buy.
4. Child-based state and local public funding must begin at current K-12 funding levels.
5. As required by existing federal law, federal K-12 funding must provide supplemental public support to special needs children on a case-by-case basis.
6. There must be minimum enrollment to qualify an educator to receive public funding to educate children.
7. There must be a way to verify the enrollment of each school.

In addition, Merrifield (2001: 12) also argues that a new school should not have to obtain permission from its major competitor, the public schools, to enter the market. In most states, the charter school authorizer is the school district, which creates excessive barriers to entry and negative incentives for authorizing charter schools.

Although charter schools are not a significant policy option endorsed by John Merrifield, charter schools actually meet several of his criteria, with the significant exceptions that charter schools restrict parental spending on K-12 instruction to the amount of the charter's per-pupil funding and charter schools face significant entry barriers. Also, because they must accept all applicants, it is much more difficult to offer high-quality, specialized schooling services. The key criteria that charter schools have come closest to meeting is that charter schools receive per-pupil funding that is close to the level of spending in the public school. And while the public schools still receive more money than charter schools, the charter school student's purchasing power is still greater than under most other existing school choice programs.

Similarly, Coulson (1999) identified a five-feature theory for market education including choice and direct financial responsibility for parents and freedom from regulation, interschool competition, and the profit motive for schools. Coulson acknowledged that charter schools meet heavily compromised versions of three of his criteria. He wrote, "Parental choice, school freedom, and interschool competition are all greater under charter programs than under conventional

government schooling, but they are still pale shadows of the conditions that exist in free and competitive markets” (1999: 339). Charter schools clearly fail the criterion that parents have financial responsibility for their children’s education. However, it does appear that for-profit schools have become a vital part of the charter school market by working around restrictions on for-profit schools by using for-profit companies to manage schools in partnership with nonprofit charter school boards. For example, I am the board president of a nonprofit charter school, California Virtual Academy, which is run by the for-profit K12 Inc.

Finally, in a recent ranking of America’s school choice programs, the Milton Friedman Foundation (Enlow 2004) graded school voucher and tax credit programs on three criteria. First, they graded student eligibility, which was defined as the need for universal choice programs that made vouchers available to all students in order to maximize educational freedom. The second grading criterion was purchasing power, with the highest grades going to school choice programs that fund students at the same level as students in traditional neighborhood public schools. The third criterion was school eligibility, which examined policies that restrict certain kinds of schools (such as religious schools) or that restrict a school’s freedom to operate through regulations such as mandated school testing. Charter schools score high on the first criteria because all students are eligible to attend charter schools and they represent true universal school choice. While many charter schools target low-income children, there are no inherent policy restrictions that limit school enrollment to low-income children. Again, charter schools score relatively high in terms of purchasing power. And while per-pupil funding in charters is not a perfect equivalent to public school funding, the trend is toward giving charters larger shares of local, state, and federal education spending. In addition, most charter schools receive funds above the average tuition for private schools.

In summary, the two greatest advantages that charter schools currently hold over most current voucher and tax credit school choice programs are more universal choice for students and more purchasing power for instructional services. On the other hand, charter schools are subject to much more complicated rules and regulations, and they do little to encourage parents to take financial responsibility for their children’s education.

Theoretical tax credit and voucher programs, as conceptualized by Friedman and characterized by economists and scholars such as Merrifield and Coulson, clearly hold the true market advantage and would result in the most freedom and educational choice. However, in

practice, charter schools have met more of the criteria of a free market in education than most current tax credit and school voucher programs.

Frederick Hess (2004: 253) recently captured this irony when he wrote:

In theory, school vouchers are likely to produce the most profound competitive effects, by creating the opportunity for the greatest expansion in potential providers and minimizing regulation on providers, while charter schooling is limited in the number of potential providers and in their operational flexibility. In practice, programs do not necessarily fit this neat continuum. For instance, Arizona and Michigan currently operate charter programs that represent a far more radical shift than the circumscribed voucher programs in Cleveland and Florida. The uncertain legal status of voucher schooling and the fact that per-pupil funding tended to be significantly lower than for students in charter schooling retarded the expansion of potential suppliers, while the more stable support for charter schools and more generous funding levels led to a dramatic expansion of charter school providers and the entrance of large-scale, for-profit ventures like Edison schools and National Heritage Academies.

There are now several geographic regions, from Los Angeles to Washington, D.C., where charter schools have created enough new school capacity to provide parents with choices at a similar or greater level than existing voucher and tax credit programs.

Evidence for the Continued Growth of Charters

There is substantial evidence that charter schools will continue to add new school capacity. Charter schools appear to have some advantage in terms of political feasibility. Unlike state and national school choice initiatives, charter schools seem to better match the reality of local school control in the United States. Because education is really a local good, it makes sense that charter schools have had more traction than other school choice initiatives. Getting one charter school or 10 charter schools approved in a local community, with local stakeholders who have a vested interest in the outcome, may be politically feasible, where a statewide voucher initiative would not be.

The number of for-profit contract and charter schools continue to increase. According to a recent report (Molnar et al. 2004), there were 463 public schools being operated by 51 for-profit management companies in 28 states as of the 2003–04 school year. The study also found that 81 percent of these schools were charter schools and that

Michigan and Arizona have the most schools managed by for-profit companies. Overall, with more than 684,000 students enrolled nationwide and more than 2,700 contracts between charter schools and their government authorizers, charter schools may be the most common example of education privatization.

To date the principal manifestation of for-profit education in K-12 schools has come from the use of for-profit corporations to manage public charter schools. Many of the for-profit companies also work in a separate line of business managing traditional public schools under contracts with school districts. The National Council of Education Providers (www.educationproviders.org) was formed in 2004 to represent the 6 largest for-profit education providers operating 9 percent of all charters with 267 schools and more than 140,000 students.

These for-profit companies have often made substantial investment in research and development for their school's management, curriculum, and assessment systems. For example, Edison developed a sophisticated benchmarking and assessment system that allows a teacher to easily target instruction to student weaknesses. Similarly, K12 Inc. is backed by a \$20 million investment from Constellation Ventures and has also received financial backing from Milken's Knowledge Universe. This ability to attract capital has led to heavy investment in R&D for K12's curriculum and school design. K12 Inc. has developed a high-functioning design for their Online School that allows parents, students, and teachers to share a sophisticated interface that covers every aspect of school curriculum, lesson planning, and assessment.

There has also been substantial growth of charter schools in the nonprofit sector, resulting in specialization and branding of nonprofit charter schools. For example, the New Schools Venture Fund has a \$40 million charter school accelerator fund focused on fueling rapid, scalable growth of nonprofit charter systems. In California alone some of the branded nonprofit charter networks include Green Dot Public Schools, Aspire Public schools, High Tech High, and Leadership Public Schools. In addition, California Alliance for Student Achievement has begun a new network of College Ready High Schools, and there are well-known national nonprofit brands such as KIPP Academies and the Seed Charter schools that are continuing to expand nationally.

These for-profit and nonprofit chains do not include the vast growth in virtual for-profit charter schools such as K12 and the scores of for-profit and nonprofit charters that operate a few schools to focus on the Montessori method, math and science, or the performing

arts. A trip to the Phoenix area to tour just a few of the wide range of charter schools would make it difficult to believe that charters are a diversion for school choice.

The philanthropic community plans on continuing huge investments into branding chains of charter schools. For example, the Philanthropy Roundtable has made a strategic commitment to charter school principles and views charter schools as their main vehicle for school reform. This group includes many business and foundation leaders from the Walton Family Foundation to the Broad Foundation to business leaders like Reed Hastings of Netflix. Some of these leaders are adopting or developing their own specific chains of charter schools—like Frank Baxter with College Ready charter schools.

In addition, the No Child Left Behind Act has created increased opportunities for charters. Urban school districts with large numbers of failing schools are increasing the opportunities for both charter schools and contract schools.

In Philadelphia, 45 of the city's lowest performing public schools are managed through contracts with independent firms. The 2004 test score data reveal that these schools have improved academic achievement for the city's most needy students.

In June 2004, Chicago Mayor Richard Daley announced his 6-year \$150 million "Renaissance 2010" plan to shut down Chicago's failing public schools and open 100 new schools by 2010. Mayor Daley has more control over Chicago's public schools than other urban school leaders because the state legislature gave him legal control of the schools in 1995.

The plan will allow the creation of 30 new charter schools and 30 new contract schools created by private groups that sign 5-year performance contracts with the district. The proposal would sell some school buildings and reconfigure some high schools and elementary schools into smaller schools, catering to no more than 350 to 500 students each. The plan will also allow 60 of the 100 schools to operate outside the Chicago Teachers Union contract.

The effort will be partially funded with \$50 million in private donations. The Civic Committee of the Commercial Club of Chicago, an organization comprising 75 leaders of the Chicago region's largest corporations, professional firms, and universities, played a key role in selling schools chief Arne Duncan and Daley on the idea of creating independent schools. The committee is leading the effort to raise \$50 million to cover start-up costs at the new schools, half of which has already been committed by the Chicago Community Trust, the Gates Foundation, and others.

Daley's plan also points to the tendency of the charter movement

to specialize in many different types of schools and replicate existing charters. For example, some of Daley's proposed schools include

- A new military charter high school for Chicago's North Side for fall 2005, through a partnership with the Naval Service Training Command at the Great Lakes Naval Station.
- A new charter school developed by the law firm of Sonnenschein Nath & Rosenthal scheduled to open in September 2005 in the city's North Lawndale neighborhood. The firm will spend about \$200,000 a year to start its school with pre-K classes and kindergarten, and then add a grade each year.
- Daley plans to replicate existing charter schools such as Chicago's Noble Street Charter School, where kids have a longer day and study in smaller classes, and Perspectives Charter School in the South Loop, where every student must land a job or show a college acceptance letter to get a high school diploma.
- A new "early college" high school linked with DeVry University.
- Daley is also considering the Knowledge Is Power program, which has two charter schools in Chicago and dozens across the country that run from 7:45 a.m to 5:00 p.m. daily, as well as a school linked with Outward Bound, the outdoor adventure group. Other possibilities include partnerships with Catholic schools, universities, nonprofits, social service agencies, and the Chicago Historical Society. For example, Chicago Public Schools officials have invited leaders of the San Miguel Catholic School to run a new public school as part of the Renaissance 2010 plan. A not-for-profit secular arm would be established for the contract.

Similarly, in fall 2004, New York City will open 8 new charter schools as part of Schools Chancellor Joel Klein's plan to develop 50 new charter schools over the next 5 years. Three of the new charter schools will open in the Bronx, 2 will be in Brooklyn, 2 will be in upper Manhattan, and one is planned for Far Rockaway, Queens. Private-sector involvement has been embraced in New York City, where private donors have invested \$41 million to help create 50 new charters in the next 5 years. In a plan similar to Chicago's, New York school officials will give the charter schools space in their buildings and provide start-up funds.

In general, this growth in new school capacity through charter schools offers parents more education choices. However, more research needs to be done to determine the extent to which charter schools may replace existing capacity in private schools. Some free-market scholars have argued that students in chartered schools are disproportionately from current private schools and that charter laws

are more likely to devastate private schooling (widely seen as free private schools) than substantially change public schooling. However, there is substantial anecdotal evidence that in many geographic regions with a concentration of new charter schools, such as Los Angeles and Detroit, the traditional public schools, and not the private schools, have lost the most students to charters.

A Three-Sector Education Industry?

While falling far short of a true market in education, what seems to be emerging is Myron Lieberman's conception of a three-sector education industry. Lieberman (1993) notes in *Public Education: An Autopsy* that the K-12 education market is most likely to evolve into a three-sector industry, with public schools, nonprofit private schools, and schools for profit all having a role to play. Of course, in the charter market all schools are public and are heavily regulated.

Recognizing that the charter movement is far from a true education market, how will advocates reconcile the fact that the school choice reform that is considered the most marginal has also generated the most growth in the crucial for-profit education sector and substantial growth in brand-name nonprofit schools?

At this juncture, charter schools appear to have the least uncertainty among school choice reforms and the widest potential for replication and growth. Purchasing power and the ability to enroll any public school student have driven the growth in charter school capacity. It turns out that freeing up large sums of government money, even with serious restrictions, is key to building new school capacity. The for-profit and nonprofit education sector is following the money to develop new schools.

The charter school paradox leaves open two possible courses of action. First, we can work to mold charter school laws to meet more of the conditions of a true market in education. This could be done by increasing competition for charter school authorizers and abolishing caps on the number of charter schools. We can also work to bolster the legal standing of for-profit charter schools in states where for-profit education is forbidden in charter schools. The second course of action is to continue to work for more robust and universal school choice programs through tax credits and vouchers and assume that for-profit and nonprofit chains that have grown out of the charter school movement will move into these new markets.

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