

# Public Funding for Higher Education: A Heresy

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An old story that I heard in Oklahoma was that there were three plums to be allocated when Oklahoma was admitted as a state: the state capital, the state penitentiary, and the state university (which was mandated under the Morrill Act of 1862). It was obvious that Guthrie would get the state capital; it was the largest city in the center of the state. However, the state university was given to Stillwater because McAlester chose first. This story may seem like a cynical view of policy, but it raises an interesting question that seems to be missing in most of our recent policy debates over funding state university. Specifically, why does the state fund education in general and higher education in particular? While some of the points raised may be salient for the debate of public funding of K-12 education, I want to focus primarily on higher education.

For the purpose of this discussion, I will posit three major goals of higher education which may be valued from a policy perspective. First, as pointed out in the story about Oklahoma, one overlooked reason or policy objective of funding higher education is regional development. I currently teach at the University of Florida in Gainesville. While the local political discussion usually bemoans the cost of providing services to students and the elimination of significant structures from the property tax role, it is an undeniable fact that the University of Florida provides economic opportunities that would not exist in the region otherwise. However, the regional development aspect raises several ancillary debates. Second, most recognize that funding higher education develops human capital which become the property right of individuals (i.e., I have been granted degrees by Oklahoma State University and Purdue University which provides me employment opportunities). The question then becomes: Why

should the states of Oklahoma and Indiana value this property right enough to invest in it by subsidizing my education? Third, apart from investing in my specific property claim on human capital, the state is investing the common pool of human capital in society. The difference between the second and third question may appear fairly nuanced, but it is important. As I will develop, the second question boils down to a distributional question while the third involves economic growth.

At one level, the funding of higher education as a regional development tool would appear specious. However, this dimension of public university funding probably has the highest return to individual legislators. Florida has eleven major public universities located throughout the state. Historically, these eleven universities have been the only publically funded institutions of higher education that have been allowed to grant Bachelor's degrees (i.e., four year institutions). Before 2008, the state funded a variety of smaller community colleges which provided Associate degrees. This two-tier system was modified in 2008 when the state allowed several community colleges to grant four year degrees in underserved areas. Before the most recent change, the controversy was in the roles of each of the eleven universities. Some contended that the University of Florida as the flagship of the system should aspire to national and international stature. However, Gainesville is not a major metropolitan area and, hence, lacks the political clout of areas such as Jacksonville (the University of North Florida), Orlando (the University of Central Florida), or Tampa-St Petersburg (the University of South Florida). Further, Gainesville is not the seat of state government like Tallahassee (Florida State University). Hence, the debate of the allocation of taxpayer funds between public universities can be colored with rent-seeking activities (Buchanan and Tullock). State legislators can "bring home the bacon" by working for increased funding for regional universities. Putting the question

slightly differently, if I am a state representative or senator from Orlando I would put little value in funding the University of Florida in Gainesville based on regional development. Hence, the regional development justification of spending on higher education is colored by whether rent seeking activities are productive or unproductive.

The second justification for public funding of higher education involves the creation of human capital for which the individual has a property right (i.e., degrees). It is generally accepted that society should fund education in general and higher education in particular because it wants its children to have access to good jobs. Neat idea, objecting to this undoubtedly lands one a social stigma roughly equal to Attila the Hun. Forgive me, but I must ask why this is so readily accepted? Thinking about this analytically, there is a general agreement that public investment subsidizes the creation of human capital which is in some sense valuable. The Bachelor's of Science degree indicates some human capital (i.e., a core competency in engineering, economics, mathematics, etc.) Private entities purchase the productive flow of that capital by paying the individual a higher salary than others who do not possess this core competency. The amortized value of this difference in earning potential is then the market value of the human capital from higher education. Taking it step by step, how would this market transaction occur in the absence of public funding for higher education? In the absence of public funded higher education other private or philanthropic organizations would provide education services (probably at a higher price).

Before the Morrill Act of 1862, higher education was provided by a variety of institutions typically linked to religious societies. However, the private calculus involved the benefits and costs through these opportunities. The cost of tuition was higher, implying that fewer individuals made the investment. Of course there are exceptions, some religious groups subsidized the

education of members or individuals in certain careers (such as pastors, church workers, and medical doctors). Working through the praxology (von Mises) without the subsidy there was less human capital in other fields (i.e., religious institutions may have little philanthropic support for engineers or economists). Hence, the private return on these degrees had to be higher to pay for the private investment. Hence, public funding of higher education reduced the price of human capital to individuals and reduced the return on human capital in most fields.

Apart from the diminution of the return many occupations, public funding may have significant distributional impacts. Specifically, investment in human capital like other investments requires a significant up-front expenditure. This up-front expenditure is composed of both out-of-pocket expenditures such as tuition and books, and opportunity costs or forgone income while the individual is attending classes. Public funding for higher education has distributional consequences for each of these costs. Undoubtedly, the Morrill Act of 1862 dramatically reduced the out-of-pocket cost of higher education throughout the United States. It created the Land Grant University System with at least one major state university in each state (in Florida the University of Florida is the Land Grant University, in Indiana it is Purdue University). Other state and federal programs have been added over time which provide scholarships which pay for a portion of the student's living expenses; reducing the opportunity cost of acquiring higher education. Before these innovations, higher education was typically the province of the well-off. Educated parents reaping the benefits of past investments in human capital were more able to invest in their children's human capital. This linkage provided support for a sustained income inequality based on family ties. Hence, state funding of higher education reduces income inequality.

Again, let me play the cynic. Suppose that my parents or I am willing and able to make the investment in human capital. We are willing to pay both the out-of-pocket and opportunity cost associated with human capital. Why would I choose to reduce the return on that investment through taxation? Further, while a portion of the state's expenditure on higher education is recaptured through increased taxation (i.e., under most tax schemes the increased salary afforded through state-subsidized higher education implies higher tax paid), the amount of increased taxation is reduced by the increased availability of human capital. In general, subsidizing higher decreases income inequality but reduces the incentive for higher education by increasing the overall level of human capital in society.

Finally, abstracting from the individual subsidizing human capital in society is hypothesized to increase the rate economic growth. The effect of human capital on economic growth is fairly well accepted. At one level we could use the ubiquitous argument that more medical research (investment in human capital) would cure cancer. What is not then made explicit is that such a cure would add years of productive life to individuals who currently die young. Similarly, increased human capital could lead to the next computer (or pet rock). At a more pragmatic level, investment in human capital could improve the management of businesses, reducing their cost of production and allowing them to deliver goods and services to consumers at lower cost. Of course the missing point of this debate is always how much investment is enough? The typical assumption is that private investment in human capital is below the optimal societal level because the personal discount rate (the way that individuals value current consumption over future consumption) is lower than the society's discount rate. Several justifications exist for this conjecture. From a risk perspective the individual's cost of risk is higher than society's (risks tend to average out across individuals). Alternately, while each

individual has a limited lifespan, society's has a much longer planning horizon. However, even if these conjectures are valid the question remains: How much higher is the optimal social investment in human capital than provided by private decisions.