

ECONOMICS OF EDUCATION





NEW

SZÉCHENYI PLAN

ECONOMICS OF EDUCATION

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ECONOMICS OF EDUCATION

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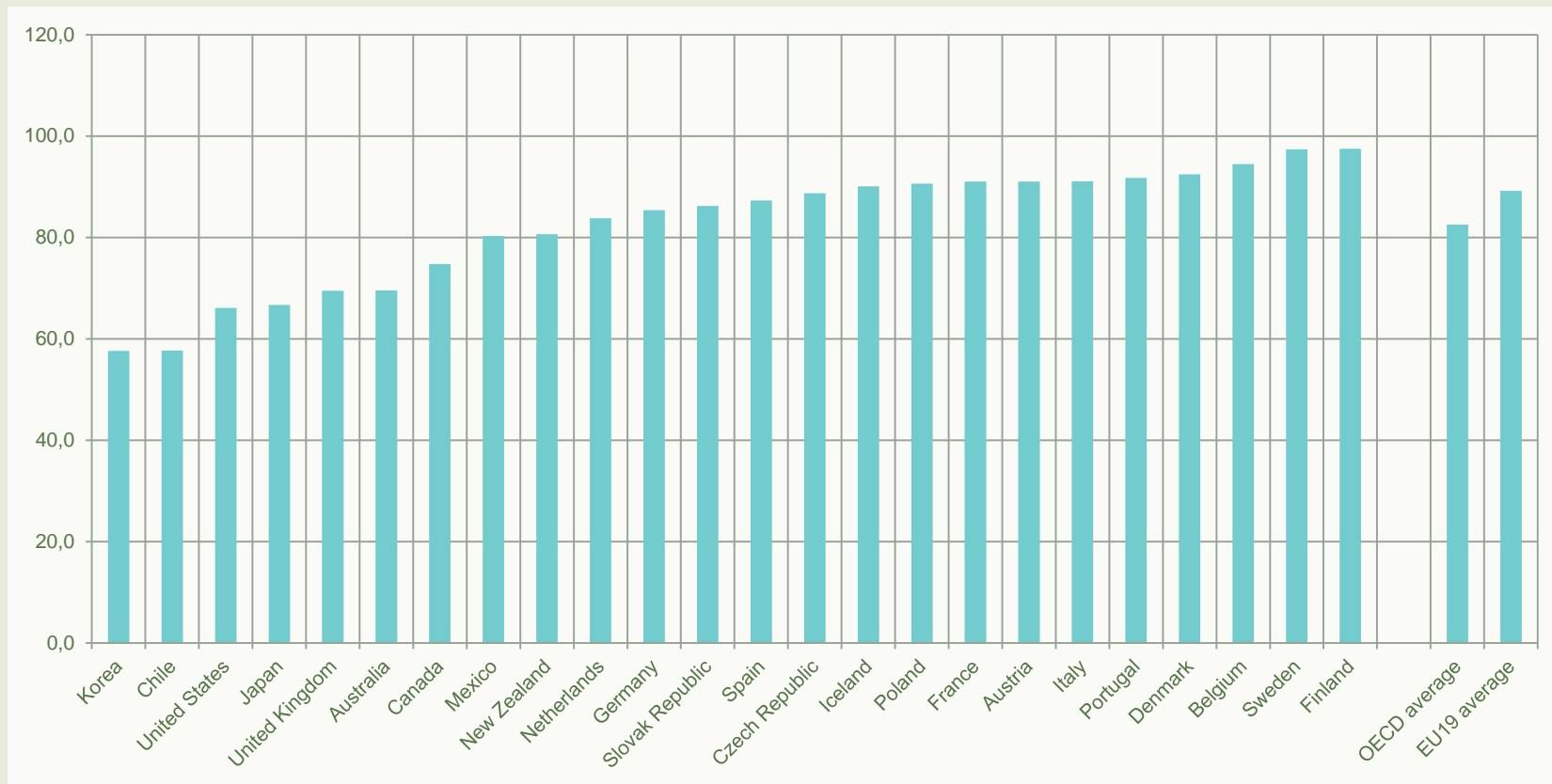
Week 3

Government investment decisions

Júlia Varga

Share of public expenditure on educational institutions 2007.

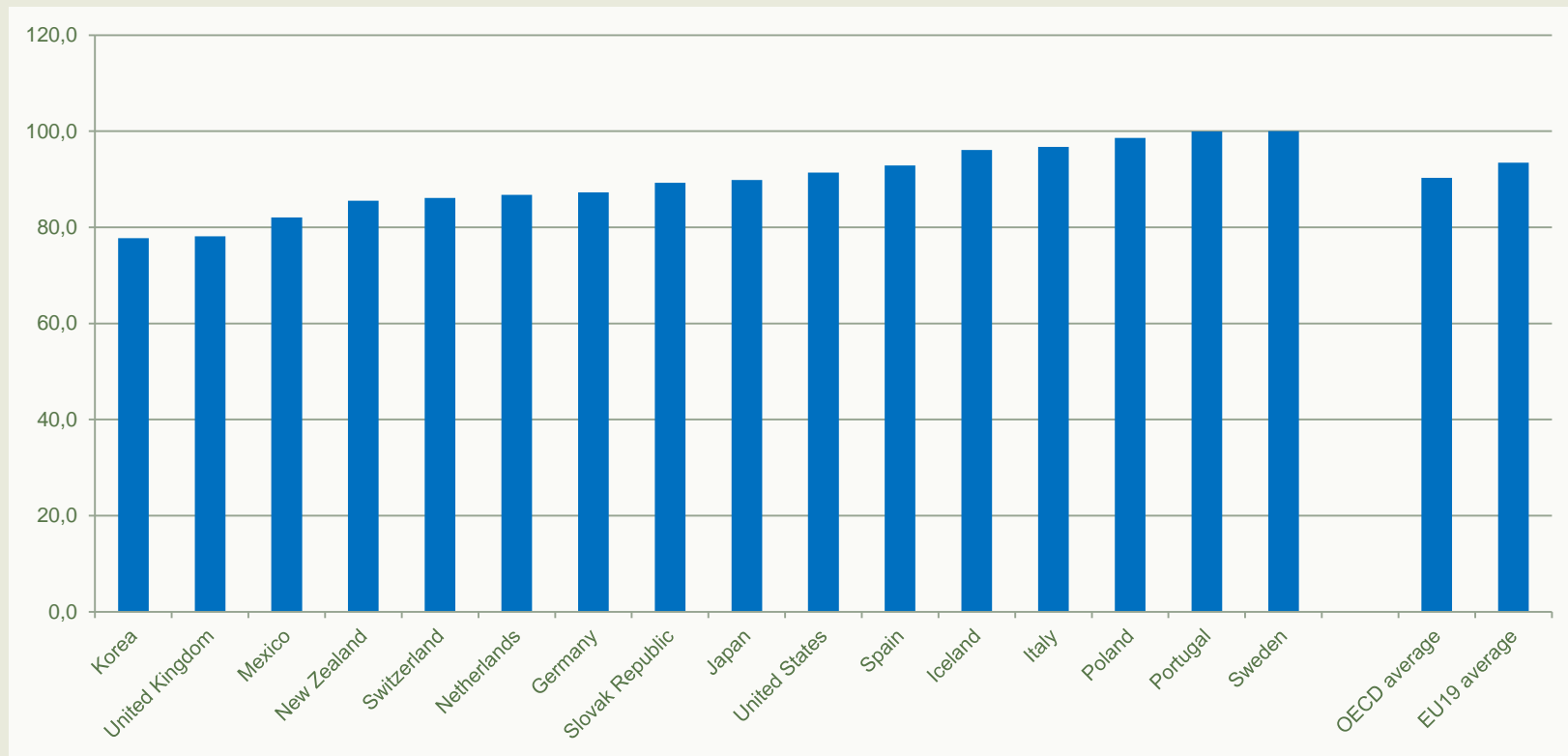
All levels of education



Source: OECD Education at a Glance 2010

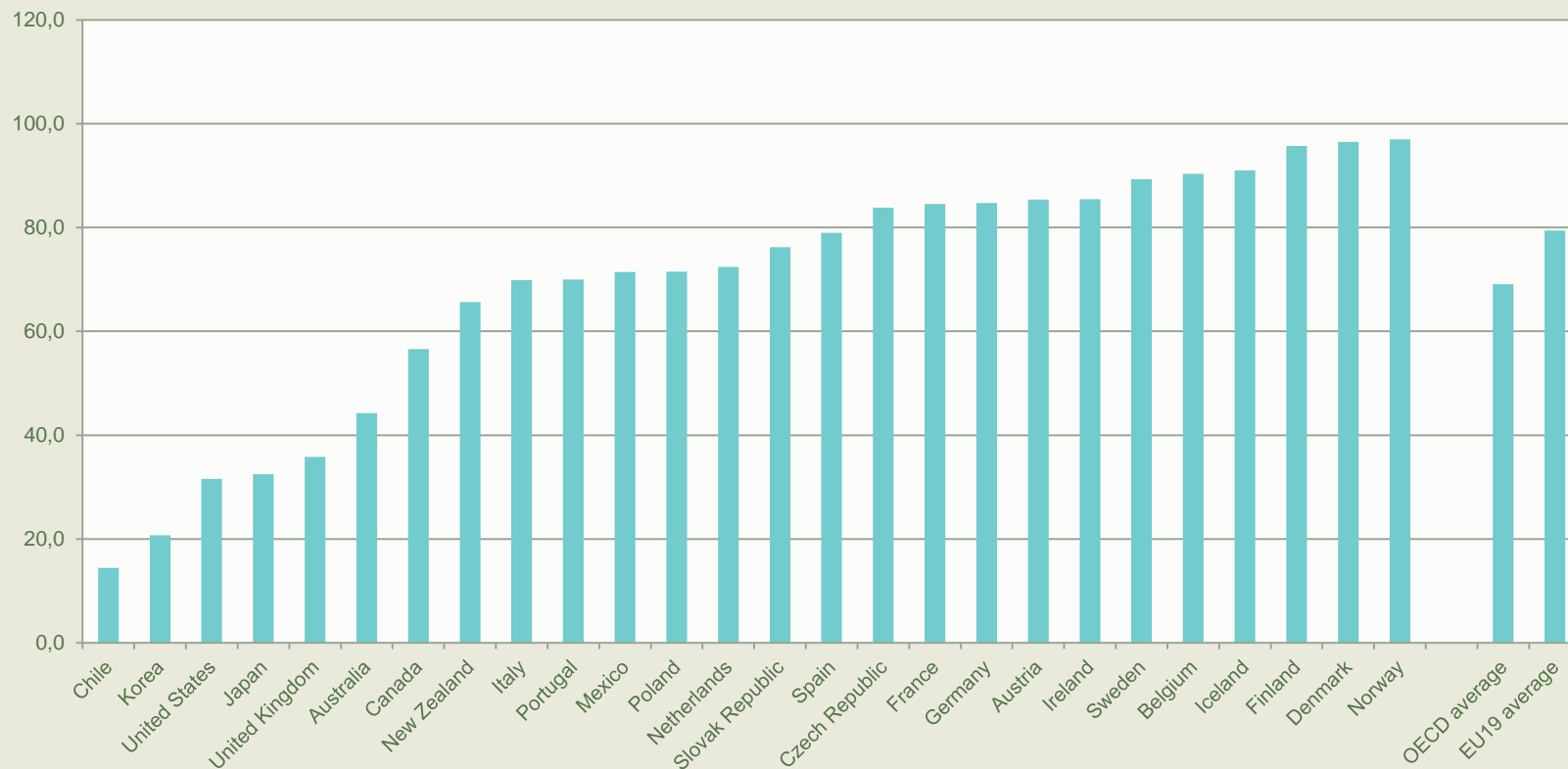
Share of public expenditure on educational institutions 2007.

Primary and secondary education



Source: OECD Education at a Glance 2010

Share of public expenditure on educational institutions 2007. Tertiary education



Source: OECD Education at a Glance 2010

Government investment decisions

1. Government is an employer → invests in human capital on similar basis as private firms.

2. To influence individuals' and firms' investment decisions
 - A) Externalities
 - B) Market imperfections may lead to wrong private decisions
 - C) The information problem
 - D) Equity reasons

A) Externalities

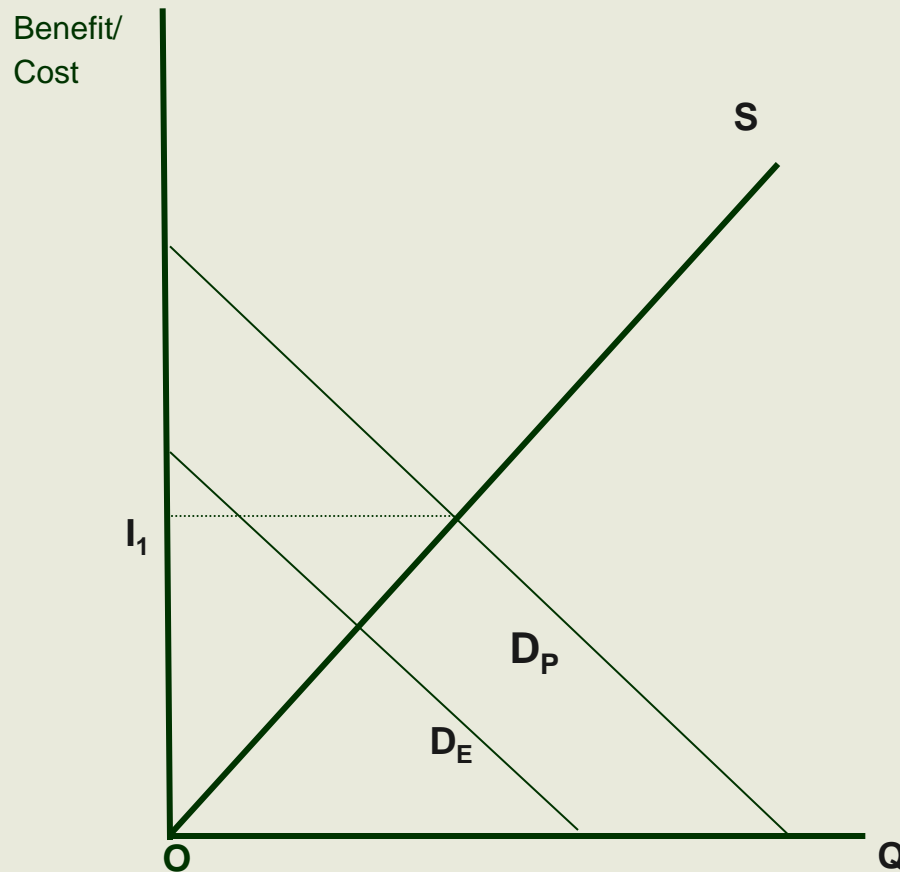
”A stable and democratic society is impossible without widespread acceptance of some common set of values and without a minimum degree of literacy and knowledge on the part of most citizens. Education contributes to both. In consequence, the gain from the education of a child accrues not only to the child or to his parents but to other members of the society; the education of my child contributes to other people's welfare by promoting a stable and democratic society.” (*Milton Friedman, The Role of Government in Education 1962*)

Major external benefits of education

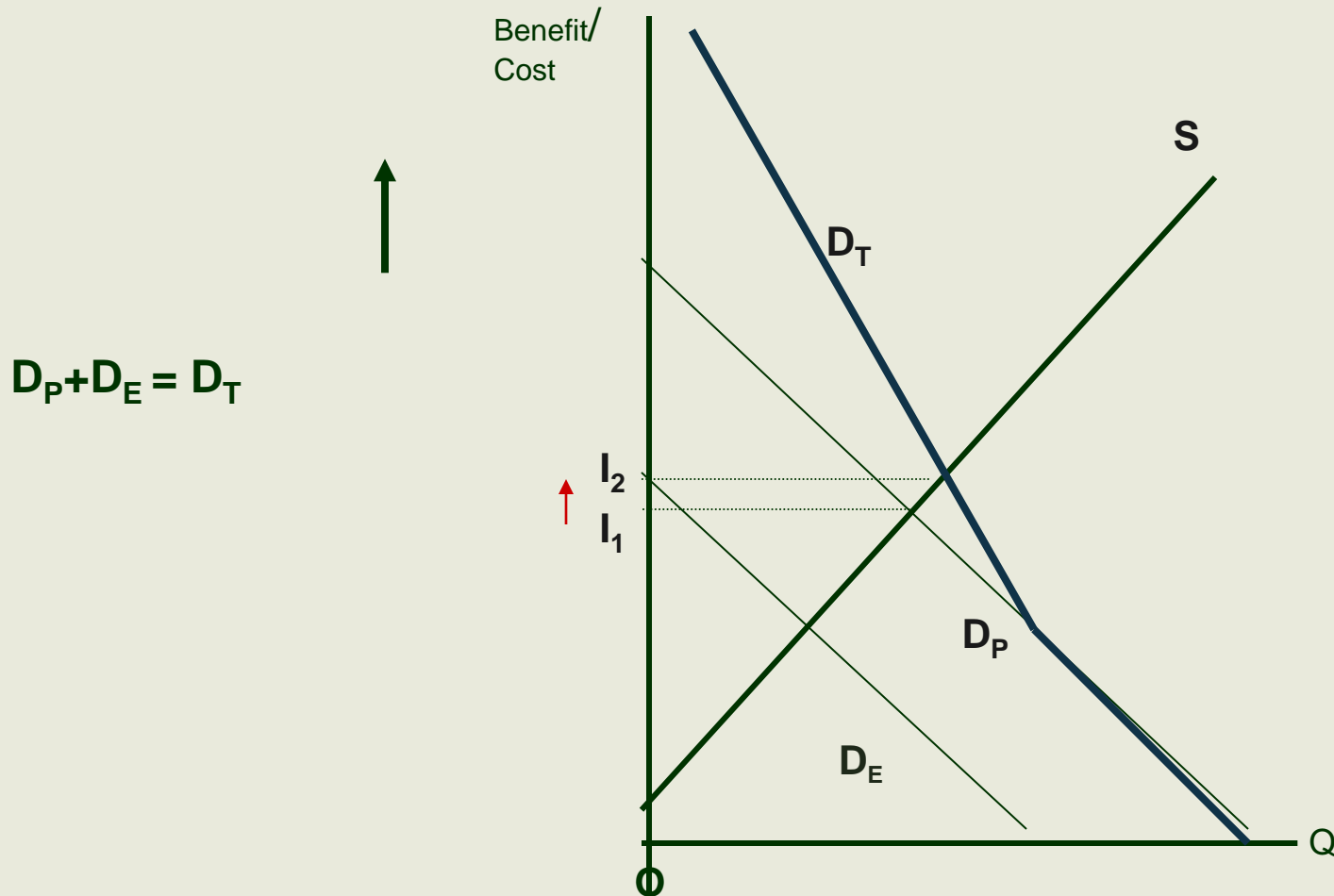
- Necessary to effective democracy and democratic institutions
- Important to the adaptation of technical change
- Lower crime rates and reduced penal system expense
- Lower welfare, Medicaid, unemployment compensation and public health costs
- Reduced imperfections in capital markets
- Public service in community and state agencies
- Complementarities in production

Optimal level of investment in education

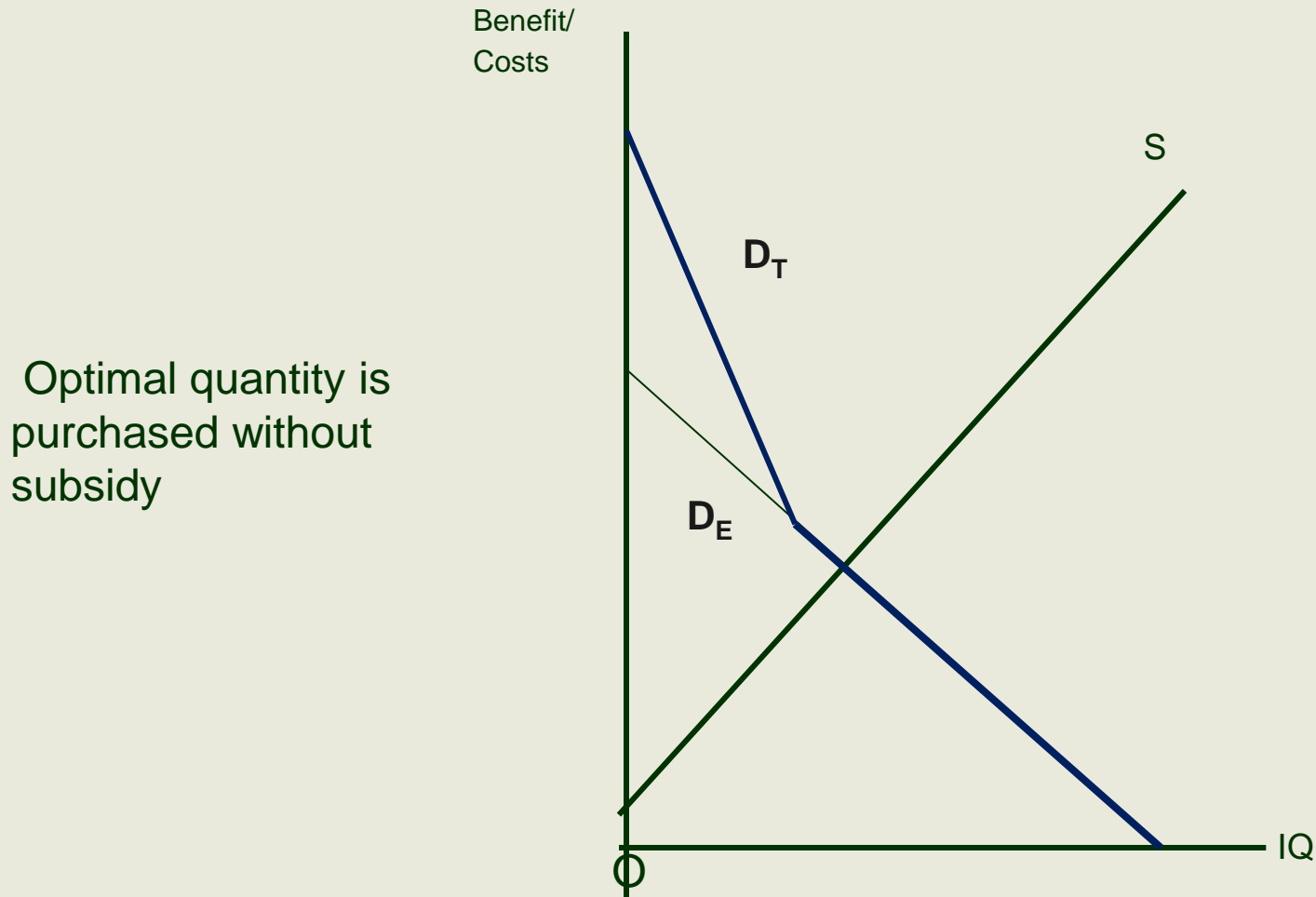
Private and external benefits



Optimal level of investment in education



Optimal level of investment in education if externalities are inframarginal

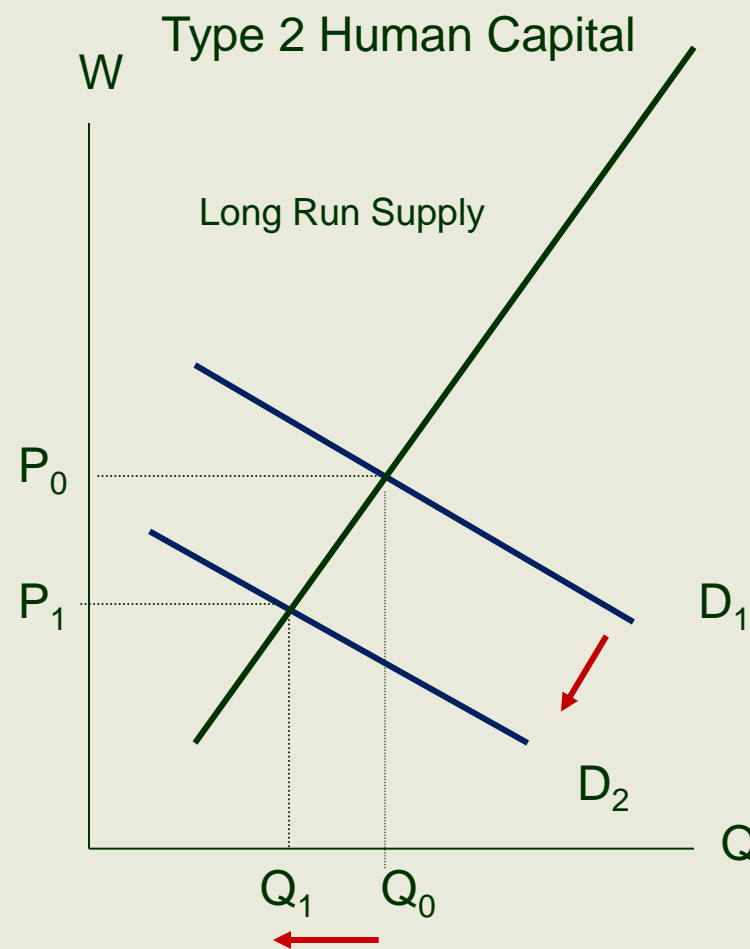
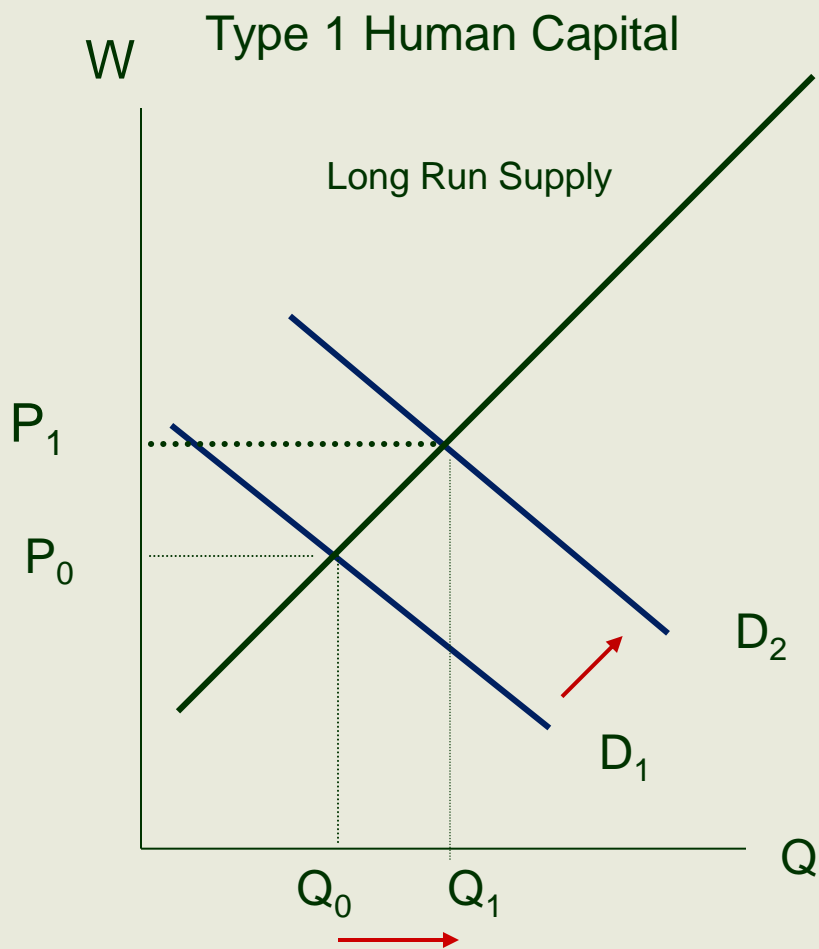


Optimal quantity is purchased without subsidy

B) Market imperfections

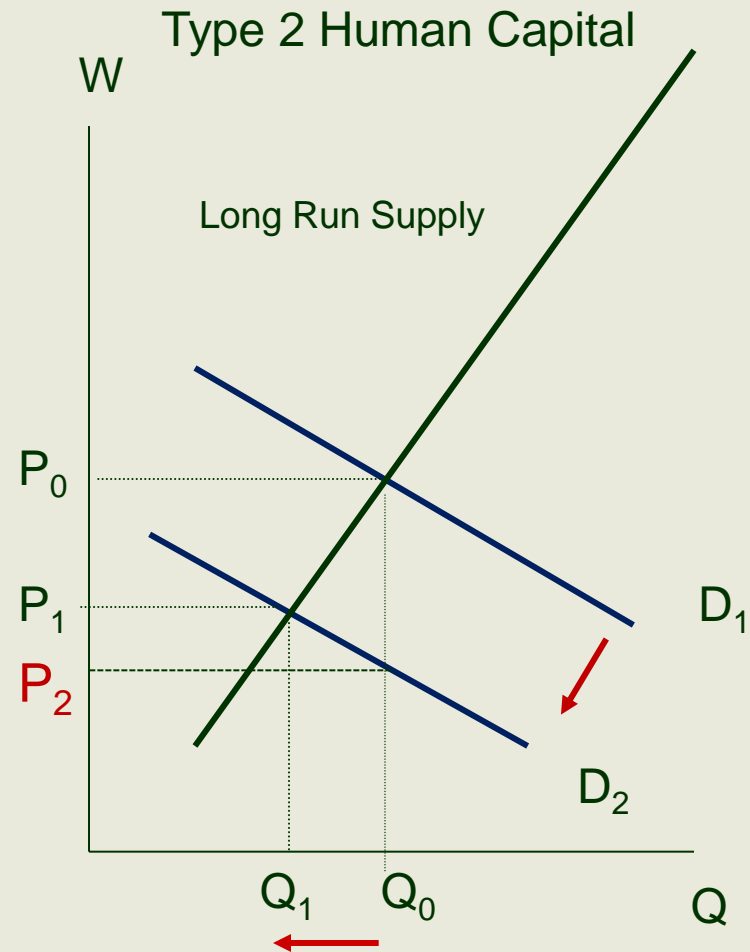
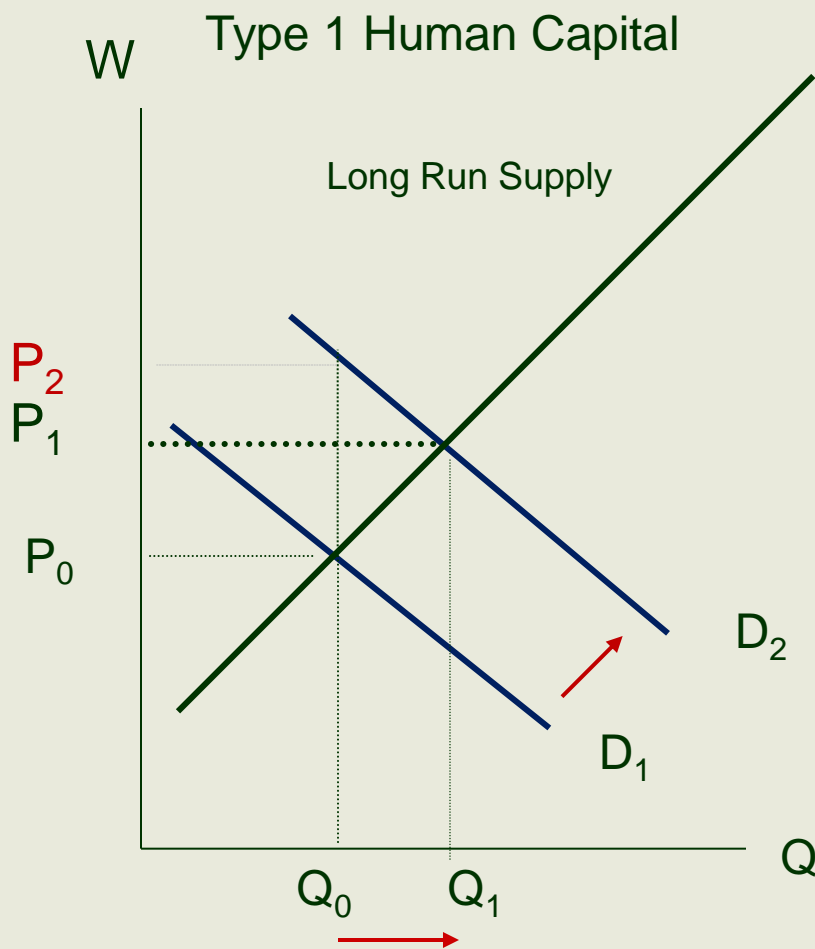
- Imperfect capital market for the financing of human capital investments (lack of collateral)
- Weak private sector training capacities

C) Imperfect informations – the cobweb cycle



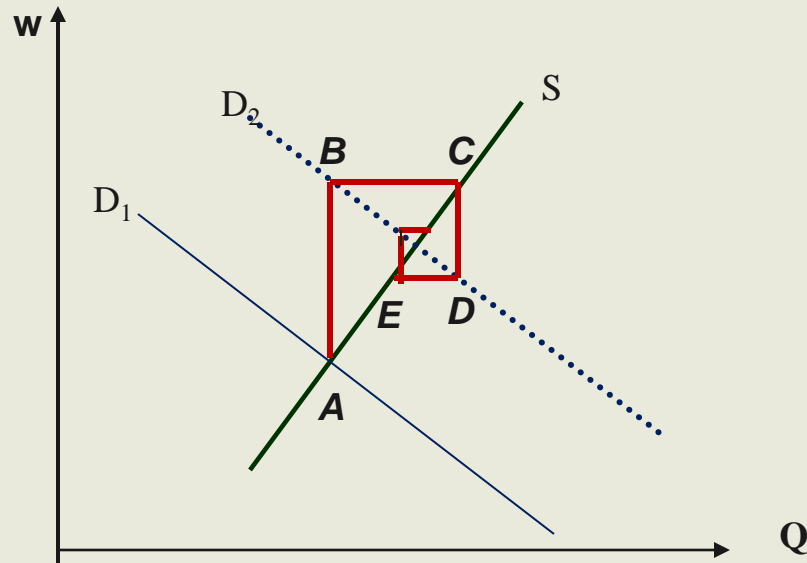
Supply adjust with a time lag as training period is long

C) Imperfect informations – the cobweb cycle



In the short run there is a price (wage) adjustment

C) Imperfect informations – the cobweb cycle



If education decisions are based on current wages

Training period 4-5 years

A–B: wage increase, increasing enrolment, supply does not increase yet

B–C: 4-5 years later – sudden increase in labor supply

C–D: wage decrease as a result of increasing supply

D–E: decreasing enrolment, 4-5 years later decrease in supply

Premises for a cob-web cycle

- Low potential mobility to other occupations
- Long training period
- No substitution between differently educated labor (inelastic demand)
- Education choices are based on actual labor market conditions