# Spending on public higher education overlooks net benefits as investment in state's future

March 10 2016

Thinking of higher education funding as an investment that lowers costs -- and not as mere consumption spending -- could reframe the debate in Springfield, according to research from Walter W. McMahon, an emeritus professor of economics and of educational organization and leadership at the University of Illinois. Credit: L. Brian Stauffer

In spite of the overwhelming evidence of a skills deficit, a depressed middle class and growing inequality, the state of Illinois continues to underinvest in public higher education. But considering higher education funding as an investment that lowers state welfare and prison costs, generates tax revenues and leads to economic growth in the future—and not as mere consumption spending—could reframe the debate, according to an article by a University of Illinois expert in the economics of education.

In the face of recent dramatic examples, including the $300 million in cuts to the University of Wisconsin budget and, in Illinois, the failure to fund public universities and MAP grants for 2016 together with the governor's proposed cuts for 2017, the investment-versus-spending distinction is a vital one, said Walter W. McMahon, an emeritus professor of economics and of educational organization and leadership at the University of Illinois.

"Since this curtailed investment in human capital would otherwise contribute heavily not only to a state's economic growth and development but also in ways estimated in the article—to higher state tax revenue and lower Medicaid, child care, welfare and criminal justice system costs—it's disheartening to see this disinvestment trend by our public officials," said McMahon, also the author of "Higher Learning, Greater Good: The Private & Social Benefits of Higher Education," published by Johns Hopkins University Press.

Published in the *Journal of Education Finance*, the article develops the total return of public education relative to the full costs to the state of Illinois, the key criteria for determining whether there is under- or over-investment for the most efficient statewide development.

McMahon concluded that public education in Illinois contributes to investment returns of 9.5 percent for K-12; 15.3 percent for community college; and 13.4 percent for university, respectively, for every dollar that's spent—returns that are well above the 7.2 percent the money would have earned if invested in an index fund that tracked returns of the S&P 500, McMahon noted.

(Updated calculations based on the newest earnings data at each education level, corrected for dropouts and other factors, show returns relative to costs of 12.9 percent at two-year institutions and 12.3 percent at the four-year institutions.)

"These earnings-based and total social rates of return both show that higher education is economically very efficient - in fact, more efficient than the average corporation in the S&P 500," McMahon said.

This measure of efficiency trumps any possible overspending on administrative costs cited by critics, so it's not surprising that U.S. higher education is widely regarded as the best in the world, according to McMahon.

"The effects are not just on better-paying jobs but are also on many outcomes beyond earnings, from better health and child development to political stability and lower criminal justice costs," he said. "Furthermore, the returns last for the 65 years or so remaining in the typical graduate's lifecycle.

"All told, the state of Illinois' education investment pays for itself every 2.3 years in state budget savings alone."

The return to the state is considerably larger if nonmonetary outcomes are considered.

"A major opportunity being missed is estimating the effects of higher education on state tax revenues and on budgeted state tax costs for health care, welfare, child support and the criminal justice system," McMahon said. "Beyond these state budget savings, I also found about a 30 percent total return that includes these wider health and other benefits to statewide development."

The paper's implications for the state's fiscal health and human capital ought to be of immediate concern to Illinois legislators and policymakers.

"The disconnect with objective benefit-cost analysis suggests the need for a new strategy in making decisions about public education financing," McMahon said. "Legislators are often focused on infrastructure issues like bridges and roads, to the extent that public education gets short shrift. Nobody likes taxes, which, if the funds are invested in education where there is a future return, are a form of forced saving. But this type of saving and investment has a huge payoff. And if done thoughtfully, it is crucial to the state's growth, development and fiscal health."

Another way of looking at the issue is that "one can also look at the same numbers as estimating the damage to the state from cuts, if they are not restored," McMahon said.

"In Illinois, what is happening is not just a disaster for higher education but also a growing disaster for the state budget, as time passes," he said. "It's a disaster for economic growth and the business climate, and a disaster for broader development and well-being of the state. Allowing Chicago State to close and not funding MAP grants, which forces students to drop out of school without the necessary skills to succeed in the working world—all of that will have serious implications for the state of Illinois that should be fairly obvious."

**More information:** The paper "Financing Education for the Public

Good: A New Strategy" is available online: papers.ssrn.com/sol3/papers.cf … ?abstract_id=2690479

Provided by University of Illinois at Urbana-Champaign