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Differential effects of the components of higher education expenditure on U.S. state economic growth

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Over the past thirty years, the importance of human capital investment in the United States has significantly increased leading to a dramatic upward pressure on tuition prices. This dramatic increase in tuition levels has raised a debate as to what should be the proper amount of the investment in human capital and what are the true effects on economic growth. Specifically, this debate is centered on whether an investment in human capital through higher education leads to the substantial positive externalities as was previously expected. On one hand, some scholars argue that greater public funding on education is needed to increase labor force productivity. On the other hand, research indicates that the cost of human capital investment has increased such that the returns no longer outweigh the costs. This paper expands upon previous research by breaking down higher education spending into specific expenditure components, such as research and instruction as well as appropriations and grant-aid, as opposed to solely analyzing the total amount of funds spent by states on higher education. A distinctive result emerges indicating that research spending is both positively and significantly related to state economic growth, while the effects of both instructional and other spending remain insignificantly different from zero. Different levels of impact are also obtained through our second allocation analysis, where results indicate both a positive and significant correlation between appropriations and growth, while grant-aid expenditure effects remain to be insignificant. In general, the evidence suggests that states with a large university research presence could benefit through increased economic growth. However, growth maximizing models may vary based upon the differing factors across states. Hence, this research finds that what may be important is not the amount spent by states on higher education, but rather, how is it spent.