The Effect of Public Finance on Higher Education under Restricted Admission: Theory and Evidence

Ronen Bar-El , Yuval Arbel and Yossef Tobol*

Abstract:

We use a simple two-period equilibrium framework, similar to Eckwert and Zilcha (2012, 2013) to explore the effects of several policy tools on the formation of human capital and on the distribution of incomes. We assume that the individuals finance their investments in higher education through income-contingent education loans and show that subsidizing education loans using either an egalitarian subsidy scheme, which reduces by a uniform amount the tuition charged to students, or a student loan subsidy which is proportional to the student's debt service obligation, both are tax financed, does not increase either human capital stock, nor aggregate consumption, but only result in income distribution mainly among the upper class. We show that policies that are aimed at improving the socioeconomic background of the low background individuals result in higher human capital stock and aggregate consumption as well as in income redistribution from top to bottom. Our results are empirically tested to validate our model.

*Yuval Arbel, School of Business, Carmel Academic Center, 4 Shaar Palmer Street, Haifa 33031, Israel, e-mail: yuval.arbel@carmel.ac.il. Ronen Bar-El, Department of Economics, Open University, Raanana, Israel, e-mail: ronenba@openu.ac.il. Yossef Tobol, School of Industrial Management, Jerusalem College of Technology, Jerusalem, Israel, School of Business, Carmel Academic Center, Haifa, Israel and IZA, Bonn, e-mail: toboly@gmail.com.