

## Outline of the Book

It has become part of the conventional wisdom in the economics of education that subsidies to higher education have a regressive distributional effect. Given that relatively more children from wealthier families enroll in higher education, many economists assume that these subsidies to higher education have an unwanted distributional impact. *The nurse is being taxed to support the higher education of the dentist's son*, as it is sometimes bluntly put.

In Germany and possibly elsewhere, this reproach concerning fiscal activity in higher education is as old as the proposal to subsidize tuition fees. In 1875, the German Social Democratic Party (SPD) for the first time expressed in its *Gotha Program* the demand for “free instruction.” Karl Marx and Friedrich Engels were the first to question this in their *Critique of the Gotha Program*: Free instruction “only means in fact defraying the cost of education of the upper classes from the general tax receipts” ((Marx and Engels, 1875[1962], p. 30); own translation).

Over a century later, the critique did not only come from the Marxists' side. The most popular economist who expressed the claim noted above was Milton Friedman. He asserted that public higher education produced a “perverse distribution of income” (Friedman, 1962, p. 105). For this reason, that thesis is henceforth referred to as the Friedman-thesis. The intuition of the Friedman-thesis is concerned with the processes of selection and allocation of students to the higher-education system. Given that children from upper-income families are more likely to obtain higher education than children from lower-income ones, it seems reasonable to assume that wealthier households gain the most from subsidies. In their book *Free to Choose* Milton and Rose Friedman express their opinion as follows:

We know of no government program that seems to us so inequitable in its effects, so clear an example of Director's Law, as the financing of higher education. In this area those of us who are in the middle- and upper-income classes have conned the poor into subsidizing us on the grand scale—yet we not only have no decent shame, we boast

to the treetops of our selflessness and public-spiritedness. (Friedman and Friedman, 1979, p. 183)

In fact, many textbook writers still refer to this thesis, even though empirical work on this issue is at best inconclusive. Moreover, the literature often confuses a cross-sectional analysis and a long-run view. It is interesting to note that almost all empirical studies are cross-sectional analyses. As such an analysis provides a snapshot of distributional impact at particular points in time, the studies can be criticized for ignoring the longitudinal dimension of the point at issue. This critique also applies to the distributional effect of higher-education subsidies (see e.g. McGuire, 1976; Bowman et al., 1986; Pechman, 1972; Beckmann, 2003). In analyzing that effect, we have to distinguish between an analysis of children from various household types, and an analysis of educated and non-educated individuals throughout their lives. For the former, a cross-sectional examination is the only alternative; for the latter, the related literature uses a long-run analysis.<sup>1</sup>

The huge empirical literature on that issue, however, provides at most only scant evidence for this thesis. The debate started with the work of Pechman (1970), which contradicted the results provided by Hansen and Weisbrod (1969a). This disputation provoked a debate on the distributional effect that lasted nearly ten years, the “Hansen-Weisbrod-Pechman” debate (see Hansen and Weisbrod (1969a,b, 1971, 1978), Pechman (1970); Hartmann (1970); McGuire (1976); Conlisk (1977); Cohn et al. (1970)). Since then, a large number of studies are published. In Chapter 2 we present and review several examinations. Empirical evidence using GSOEP-data is provided in Chapter 3.

The literature covering the longitudinal approach is inconclusive. For example, building on Grüske (1994), García-Peñalosa and Wälde (2000) argue that “[i]f the average tax payer has a lower lifetime income than the average university graduate [...], a subsidy to higher education financed from general taxation implies reverse lifetime redistribution, i.e. redistribution from the poor to the rich.” Although the paper provides several very enlightening results, this approach can be critically assessed with respect to two aspects. First, it does not distinguish sufficiently between the change of distribution between *rich* and *poor*, and that between graduates and non-graduates throughout their lives. Second, Pareto-improving subsidies can also be identified as *regressive* using this approach,<sup>2</sup> as shown in Sturn and Wohlfahrt (1999, 2000).

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<sup>1</sup> See e.g. (Atkinson and Stiglitz, 1985, p. 263) who argue that “[i]n empirical work, the unit of analysis is typically taken as the nuclear family or household, and the distribution based on all such units in existence at a particular date. On the other hand, the lifetime approach seems more relevant to *individuals*. A person may belong to several different families during his life, and it makes little sense to regard him as changing identity on leaving or entering a nuclear family.”

<sup>2</sup> In a subsection, García-Peñalosa and Wälde (2000) also ask whether a particular individual is better or worse off if education is subsidized. They point out that