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Efficient education subsidization and the pay-as-you-use principle

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Abstract

We investigate whether the pay-as-you-use principle of public finance should apply to education subsidization for children to internalize human capital externalities in an intergenerational model with endogenous fertility, leisure, and accumulations of human and physical capital. We characterize social optimality concerning physical and human capital accumulation, leisure, labor, and fertility to guide the design of efficient education subsidization. We show that efficient education subsidization requires future generations benefitting from it pay for it when fertility and leisure are endogenous. Namely, the government should uphold the pay-as-you-use principle to subsidize children's education by deficit and repay the debt by future taxes.

Keywords: Education subsidization; Government deficit; Leisure; Fertility; Human capital externalities; Income taxes

JEL Classifications: H2; I2; J1; O1

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