The Impact of Education Spending on Economic Development
Minnesota Public Finance Note #2000-01

Is there any empirical evidence to support the view that high quality local schools have a positive impact on local economic development?

It is reasonable to expect that high quality local schools would have a positive impact on local economic development. High quality schools can increase the local supply of skilled workers, either by “producing” them locally or by attracting them into the area. The increase in supply of skilled workers drives down the price of their labor, reducing business costs.

Despite this intuition, however, there is a lack of convincing empirical evidence on the relationship between economic development and the quality of local schools.

The empirical evidence is clouded by several factors. First, that education services can reduce business costs is only part of the story. High quality local schools generally must be financed by local taxes, which are another business cost. Therefore, the net effect on business activity of educational improvements, when financed by higher local taxes, is unclear.

Another reason for the lack of evidence is the tenuous empirical relationship between current education spending and educational outcomes. That is, even if it can be shown that educational improvements promote economic development, it has not been convincingly shown that increases in school spending improve educational outcomes.

This ambiguity arises for several reasons. First, a wide range of socioeconomic variables affect the educational outcomes that will result from a given level of spending. Second, educational outcomes are the cumulative result of past spending decisions, not just current spending levels. Finally, current spending is largely an investment in future, not current, workers. If those workers leave the area after graduating, the community’s investment will not have improved the quality of the local workforce.
Does the lack of convincing evidence mean that communities should not invest in their schools?

No. While communities may consult the research, they need to consider other factors when making spending decisions.

First, researchers define economic development variously as changes in population, employment, income, or number of firms. Individual communities may wish to affect other variables with their spending decisions.

Second, the absence of a consensus among researchers on the relationship between education spending and economic development does not mean that a relationship does not exist. Some studies show a positive impact of education spending, while others do not. It is not yet clear which studies, if any, have isolated the true relationship.

Finally, many studies have looked at spending and economic development at the state level. The characteristics of a particular community, however, may differ from the state average. Community members may observe an impact of school spending in their area that is lost when data are aggregated.

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