

## **Democratic Forum on the Economy**

### **“Addressing America’s Economic Challenges in the Wake of Hurricane Katrina”**

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Mr. Chairman and distinguished members of Congress, it is an honor to discuss with you an issue that I’ve been thinking much about over the past few months – the costs of inadequate education and what we might possibly do about it.

One of the strongest and least controversial relationships in our economy is that between education and income: those with more education earn higher incomes. Indeed, because of this relationship education is one of the main routes for upward mobility. Figure 1 shows this relationship. Using data from the *Current Population Survey* – a national survey of about 60,000 households in the U.S. – the figure shows the average annual earnings of individuals by their level of educational attainment. The relationship is fairly flat until individuals have completed the 10<sup>th</sup> or 11<sup>th</sup> grade and then the increase in earnings associated with each additional year of schooling grows sharply. High school graduation has become a dividing line between making it and not making it in the U.S. labor market. And yet, current estimates suggest that nearly 30% of students do not complete high school.

Why is education so important? Most believe that education bestows valuable labor market skills. As such it is not surprising that high school drop-outs lack the skills

that employers value and therefore have worse labor market outcomes.<sup>1</sup> For example, only about one-half of high school dropouts are employed compared to nearly 70% of those with a high school degree (and no further education). They typically work only about 27 weeks out of the year compared to those with a high school diploma who work about 36 weeks per year. And their annual earnings are about one-half that of those with a high school diploma (\$12,000 vs. \$22,000).

Thus, one of my main concerns about the individuals displaced due to the events of the Gulf Coast – particularly those from New Orleans – is that many of them were among the most vulnerable in our population. A large fraction of them lack valuable labor market skills which will make it difficult for them to get reestablished in new areas. I particularly fear for their wellbeing since many of them likely relied on extended family in a multitude of ways, such as for child care and housing, in order to get by.

I also fear for the wellbeing of the children – not only in the short-term, but also in the long-term. Not only does a lack of skills affect the adult outcomes of current high school dropouts, but it will also affect the adult outcomes of their children, too. Indeed, there is a strong correlation between the socio-economic status of families and the educational attainment of their children. Figure 2 shows the percentage of children who have completed a high school degree or diploma by age 20 by the socio-economic status (SES) of their families divided into quartiles based on the *National Education Longitudinal Study of 1988*, a nationally representative survey that started following a group of 8<sup>th</sup> graders in 1988. Approximately 74% of the children whose families were in the lowest quartile earned a high school degree by age 20 compared to nearly 99% of

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<sup>1</sup> Whether or not an individual has completed high school is, admittedly, a narrow concept of the adequacy of education, but it is easily quantified and is quite important.

those whose families were in the highest quartile.<sup>2</sup> Flipped around it suggests the high school dropout rate is 25 times greater for the most disadvantaged than for the most advantaged. Because of their relatively low level of educational attainment, these children from low SES families will go on to have difficulties in the labor market as well.

Why should we care? Obviously we care out of compassion, but as a society we should care for more selfish reasons as well. High school dropouts cost society in a variety of ways. Next month Teacher's College at Columbia University is sponsoring a two-day symposium which will highlight the social costs of individuals having an "inadequate education." Social costs include income and tax revenues, as well as increased crime rates, poorer health, increased reliance on transfer payments, increased homelessness, and even decreased participation in the political process and in civic activities.

Figure 3 is based on data from my paper for that symposium and it highlights the income and tax revenue losses that accrue from "inadequate education."<sup>3</sup> Specifically, it considers the following hypothetical: there are approximately 600,000 18 year olds today who will dropout of school before completing high school and who will not complete their degree. If we were to increase the schooling of these individuals by one year, what would be the lifetime income and tax revenue gains? From this one cohort alone, the lifetime income gains would be about \$72 billion and the gains in federal and state income taxes would be about \$16 billion; if we add in Social Security taxes that gain would increase to about \$27 billion. These are large numbers, especially when

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<sup>2</sup> The dropout rate in these data is lower than that in other national data because it starts with a sample of 8<sup>th</sup> graders.

<sup>3</sup> Rouse, Cecilia Elena. "The Labor Market Consequences of an Inadequate Education," Princeton University mimeo, September, 2005.

aggregated over multiple cohorts. Clearly, there are large income and tax revenue losses to individuals not completing high school. When we add other social costs – particularly the effect on crime -- the numbers skyrocket.

So, what can we do about it? Well, I actually think that we know; we just don't want to contemplate it because the price tag associated with the most effective interventions is typically large. For example, as shown in Figure 4, very solid academic research has shown that for each dollar we spend on high quality preschool (as in the Perry Preschool Project, Abecedarian, and Chicago Parent-Child Centers) the social return (which includes income, crime savings, and the like) is between \$3 and \$7. These programs cost between \$5,000 and \$14,000 per child per year as well so they are not cheap. But they generate meaningful change in the lives of the children and they pay for themselves. Similarly, we have good evidence that smaller class sizes in elementary grades can make a big difference to the children in those classes. The long-term benefit-cost ratio (including only income) from the Tennessee class size experiment, Project STAR, (which cost about \$9,000 per year per student) is nearly \$3 for each dollar invested. Finally, we have evidence that even investments later in life pay off as well. A college education – even that obtained in a community college – results in higher wages and better jobs, and the Job Corps training program results in participants completing the equivalent of one more year of schooling which leads to higher wages as well.

Thus, I would argue that if we are to address inadequate education, we must focus both on young adults as well as children. We know that high quality job training (including community college), smaller class sizes, highly qualified teachers, and high quality preschool can make a difference. But, these interventions are not cheap. And

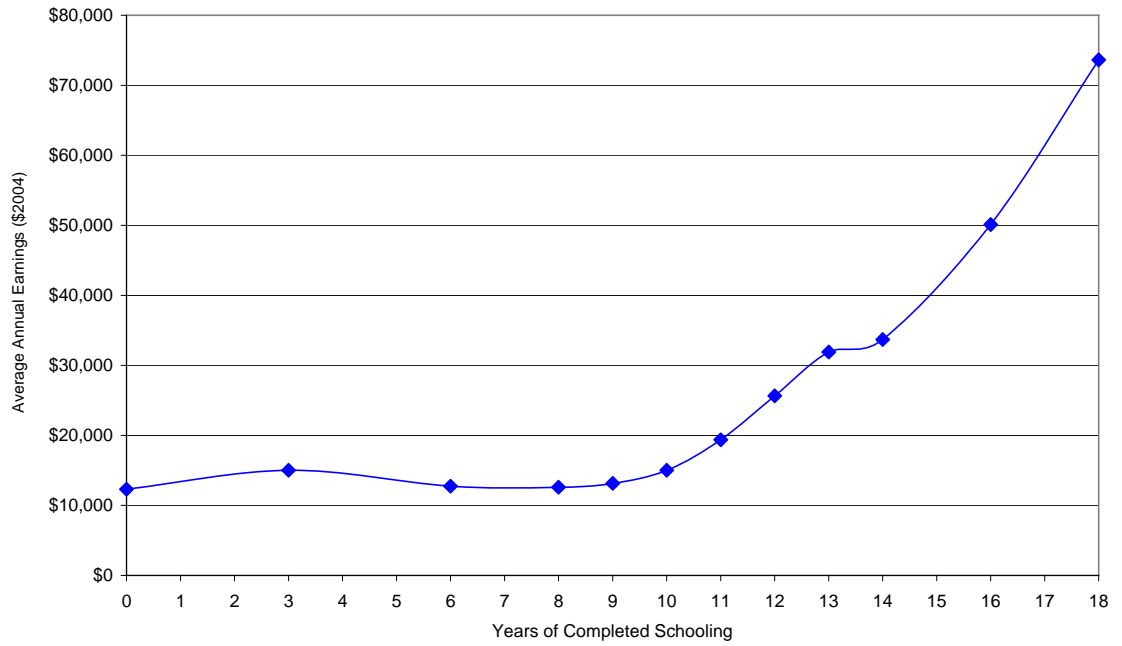
many may ask if there are not less expensive ways to improve school effectiveness such as through school accountability systems or vouchers. Some of the early evidence on school accountability programs suggests that they may lead to small improvements in student outcomes; the best voucher evidence is decidedly mixed. One general rule that appears to be emerging, however, is that small investments beget small improvements; larger investments beget larger improvements. Indeed, in education, as elsewhere in life, you get what you pay for.

What are some of the immediate concerns that come to mind in the aftermath of Hurricane Katrina? My first concern is for the students – young and old – who were displaced from their regular educational institutions. It is critical that they receive a high quality education. This means that the youngest children need access to high quality pre-school and that the older children need access to high quality elementary and secondary schools. However, this may be easier said than done. For example, I imagine that class sizes have increased in the areas to which children were evacuated which could have long term consequences for them as well as society (particularly since the evidence suggests that small class sizes are particularly important for low-income and minority children). In addition, many older students who were struggling to attend local two and four-year colleges have found their educational plans severely disrupted. Delgado Community College and Dillard University are two examples. Both colleges serve a very disadvantaged population and both campuses suffered severe damage which will make it harder for their students to continue their schooling. It is important that we find effective ways to help the most vulnerable members of our society achieve higher levels of

educational attainment; it will not only benefit them, but their children and society as well.

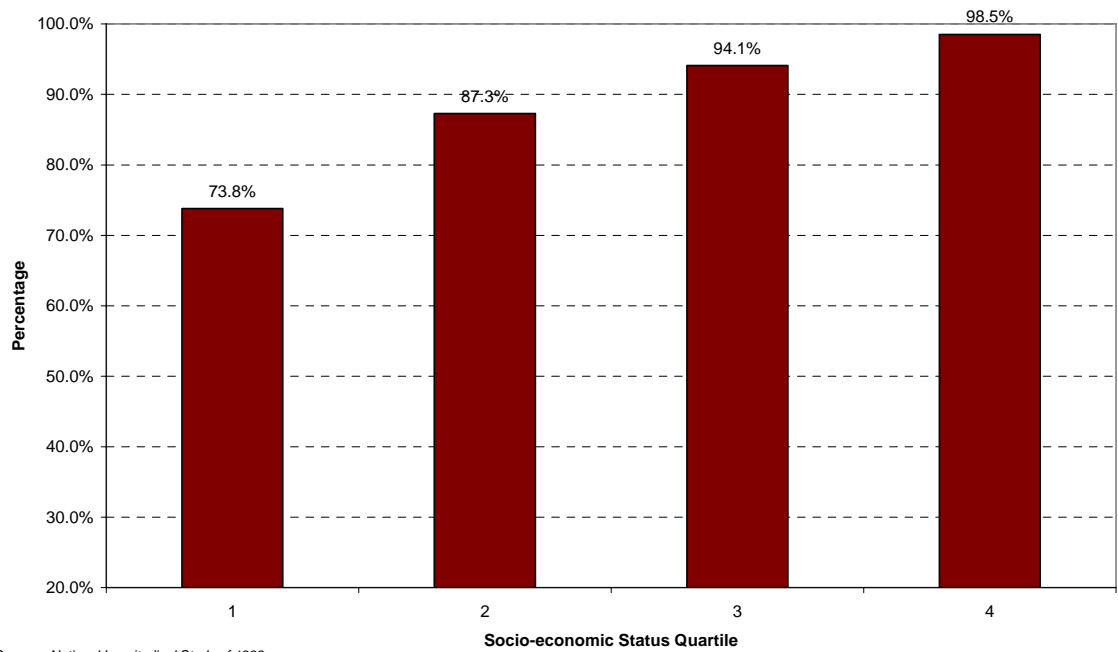
Thank you.

**Figure 1. Average Annual Earnings by Years of Completed Schooling**



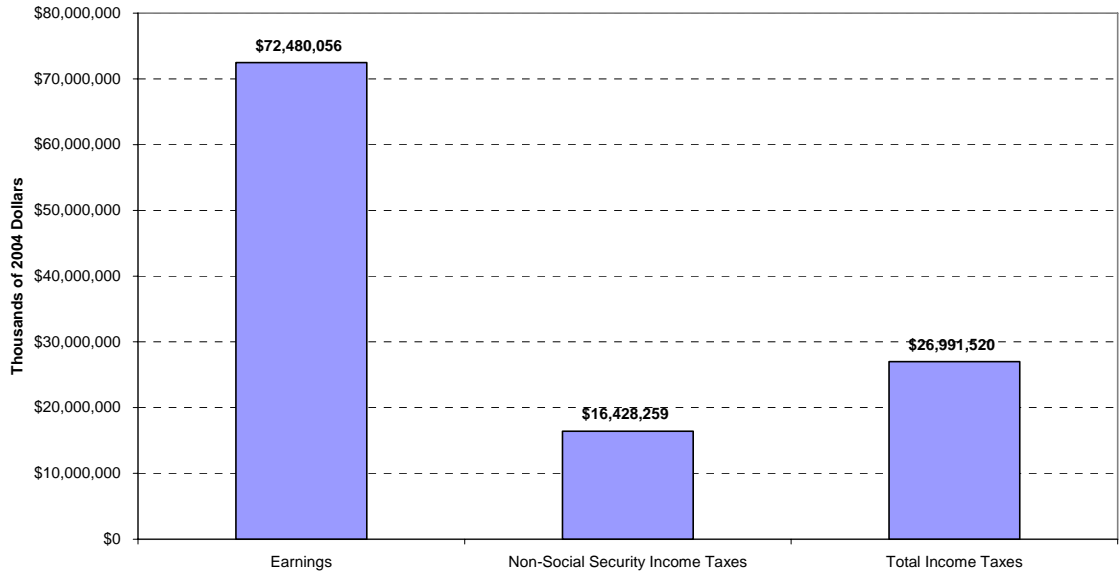
Source: *Current Population Survey*, March 2003 and 2004.

**Figure 2. Percentage of Individuals with a High School Degree by the Socio-economic Status of their Family**



Source: *National Longitudinal Study of 1988*.

**Figure 3. Potential Lifetime Earnings and Tax Revenue Gains to Increasing the Schooling of One Cohort of 18 year old Dropouts by One Year (in thousands of dollars)**



Source: March Current Population Survey, 2003 & 2004 and TAXSIM.

**Figure 4. Benefit-Cost Ratios for Society Across Interventions**

