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Some Thoughts on Poverty and Failure in the Market for Children’s Human Capital

LYNN A. STOUT*

Poverty is often described as a problem of inequitable or unjust distribution of resources.¹ But poverty raises questions of efficiency² as well as equity. This essay considers one of poverty’s economic aspects by examining imperfections in the markets for human capital investment in general and for children’s human capital in particular.³ Its thesis is that persistent and endemic market failures may be leading the United States to invest too little in the education, socialization, and nurturing necessary to transform children into productive adults. Like the society that eats its seed corn, we impoverish ourselves by consuming the resources we should invest in the next generation.

Discussions of human capital often define human capital investment narrowly, focusing on formal education and training in public and private schools. This essay uses the term more broadly to refer to any investment that increases the value of an individual’s labor to others.⁴ Thus, one can invest in children’s human capital not only by formally instructing them in reading, writing, and arithmetic but also by providing medical care, by

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² This essay employs the Kaldor-Hicks test for efficiency. Under the Kaldor-Hicks criterion, a reallocation of resources is efficient if the person who benefits from the reallocation would be willing to pay compensation sufficient to compensate the loser of the resources. The compensation need not actually be paid. See generally DAVID W. BARNES & LYNN A. STOUT, CASES AND MATERIALS ON LAW AND ECONOMICS 16-17 (1992); POSNER, supra note 1, at 12-15.

³ The phrase “human capital” draws from the analogy of physical capital to refer to the capitalized value of an individual’s labor as a factor of production. Expenditures that make individuals more productive—including expenditures on education, training or health care—are investments in human capital. See ROGER L. MILLER, INTERMEDIATE MICROECONOMICS: THEORY, ISSUES, AND APPLICATIONS 418-19 (3d ed. 1987) (investment in human capital is any activity that raises a worker’s marginal productivity).

⁴ The phrase human capital was first popularized by Gary Becker, who used the term to refer not only to investment that increased an individual’s expected earnings but also to investment that increased consumption value. See generally GARY S. BECKER, HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS WITH SPECIAL REFERENCES TO EDUCATION (2d ed. 1975). This essay focuses only on the former.
inculcating socially cooperative values (e.g., respecting others' persons and property), and by informally encouraging other habits employers desire (e.g., arriving on time, keeping to a schedule, and following instructions). Society invests in children not only in schools but churches, neighborhoods, and the home. The valuable resources invested include not only money but other scarce commodities such as time and attention, including the time and attention necessary to invest money wisely.\(^5\)

Investing in human capital can increase the wealth of both individuals\(^6\) and societies.\(^7\) Persons who are illiterate, undisciplined, or chronically ill are likely to earn subsistence wages if they can find work at all.\(^8\)

5. The suggestion that market failure may discourage social investment in children is not inconsistent with the view that a substantial part of those resources that are invested are misspent. There are reasons to suspect that the public resources allocated to children's human capital are not always invested wisely. For example, interest groups such as teachers' unions or social services bureaucracies may exercise undue influence over public funds earmarked for children's education and support. Similarly, because state-subsidized public schools face only imperfect competition, incentives to teach well and efficiently are limited. While such problems are real, this essay's primary focus is on the overall level of social investment in children, rather than on proposed reforms (such as school vouchers) intended to increase returns from any given level of investment in human capital.

6. A vast economic literature documents the relationship between formal education and earnings. *See generally* Becker, *supra* note 4; Elchanan Cohn, *The Economics of Education* 125-58, 187-233 (1975). While there is some debate whether the U.S. educational system really increases individuals' productivity or merely identifies those individuals who are most productive, Joseph E. Stiglitz, *Economics of the Public Sector* 314 (1986), most economists believe that it is at least possible to increase an individual's productivity through education and training. *See, e.g.*, Becker, *supra* note 4, at 6 (opining that screening is a minor influence in increased earnings that follow education); Stanley Fischer et al., *Economics* 303 (2d ed. 1988) (evidence suggests that a pure signalling argument is wrong and that college education does raise productivity).

Of course, for some individuals the returns from investing in human capital are likely to be small or nonexistent. For example, even a large investment of resources may not improve the productivity of the severely mentally or physically disabled. When an investment in human capital produces an uncompetitively low return, a better solution to poverty may be simple wealth transfers. *See infra* note 7 (discussing wealth transfers).

7. An alternative solution to poverty is simply to transfer existing wealth from richer to poorer individuals. Wealth transfers by definition do not increase the overall level of wealth enjoyed by a society, as any wealth increase enjoyed by the transferee must be matched by a wealth loss by the transferor. Indeed, to the extent that transfers involve transactions costs, they reduce net social wealth. In contrast, a strategy of alleviating poverty through human capital investments that increase the productivity and earnings of poor individuals increases the wealth not only of the poor, but of society as a whole.

8. Estimates that as many as 30% of young adults in the United States lack basic reading skills, *see* Richard J. Murnane & Frank Levy, *Education and Training, in Setting Domestic Priorities: What Can Government Do?* 185, 191 (Henry J. Aaron & Charles L. Schultze eds., 1992) (National Assessment of Educational Progress has claimed that 30% of adolescents and young adults in the United States lack basic literacy skills), as well as the business community's protests that the American labor pool is unfit to compete in a global economy, *see* Troy Segal et al., *Saving Our Schools, BUS. Wk.*, Sept. 14, 1992, at 70, 72 (discussing the business community's dissatisfaction with public education and its attempts to aid in school
and otherwise investing in children so that potential employers value their labor more highly when they reach adulthood increases their chances of finding employment and earning good wages and decreases their risk of falling into poverty. Society benefits as well, as more productive individuals contribute more to social wealth and are less likely to depend on transfer payments from others for subsistence.

If the market for human capital functioned perfectly our society would invest in children’s human capital up to the point at which the marginal benefits of further spending equalled the marginal costs. Unfortunately, economic theory suggests that the market for children’s human capital may be rife with imperfections that lead our society at all levels to invest too little in children. This essay models the decision to invest in children from the perspectives of three possible sets of investors: children themselves, parents, and society as a whole. Economic analysis suggests that market imperfections are likely to discourage each set from investing the optimal amount of resources in children’s human capital. Taken as a whole, these market failures relentlessly promote chronic underinvestment in children. Such underinvestment may contribute substantially to individual and social poverty, as seems likely, the society that underinvests in its children suffers opportunity costs that cannot be redressed by investing in those children later, when they become adults.

reform), suggest that a significant portion of the U.S. population lacks the skills and habits necessary to command high wages.

9. This statement implies that at least some poor individuals remain poor not because jobs that pay a reasonable wage are unavailable, but because they lack the skills and habits necessary to appeal to employers. Of course, human capital investments that improve the productivity of a large number of individuals will increase the total available supply of skilled labor. To some extent that increase in supply will depress wage rates. Nevertheless, investments in human capital that increase the marginal productivity of persons relative to the marginal productivity of physical capital will, on the whole, increase the wages employers are willing to pay. See generally MILLER, supra note 3, at 402-07 (1978) (discussing the marginal productivity theory of wage rates).

10. Both costs and benefits should be discounted to present value.

11. This essay approaches the question of human capital investment from a theoretical perspective by modelling the decision to invest and examining potential sources of market failure that ought, other things being equal, to discourage optimal investing. It does not attempt to empirically measure or compare actual and optimal levels of social investment in children. Nor does it address which investment policies or programs might produce the greatest social returns for a given level of investment. Our society may in fact spend vast amounts on public schools, AFDC, Head Start, and other programs that ostensibly invest in children, but lose much of the potential benefits of such investment to administrative waste and interest group politics. See supra note 5.

12. The assumption that investing in children’s human capital offers unique social benefits that cannot be replicated by investing in adults is crucial to the analysis of market failure presented in this essay. Otherwise, underinvestment during childhood could be costlessly corrected by investing in adult human capital instead.

There are a number of reasons to believe that failing to invest in children imposes a
That investing in human capital can alleviate poverty is hardly a novel idea. Nor is the observation that market failures may discourage optimal human capital investment. Economists frequently note, for example, that education may provide external benefits that individuals ignore in deciding how much education to pursue, or that imperfect lending markets may preclude poor persons from borrowing money to invest in their own human capital even when investing makes economic sense. Yet discussions of human capital investment often overlook some of the most fundamental sources of failure in the market for children's human capital. This essay touches upon some crucial sources of market failure that have been relatively neglected in the human capital literature. In doing so it suggests that the obstacles to optimal social investment in children may be more myriad and intractable than generally assumed. Unless those obstacles can be overcome, society is likely to continue to underinvest in its children, and so continue to suffer an unnecessarily high incidence of individual and social poverty.

unique opportunity cost on society. First, many educators believe that childhood learning lays an essential foundation for later learning. See, e.g., NATIONAL COMM'N ON EXCELLENCE IN EDUC., A NATION AT RISK: THE IMPERATIVE FOR EDUCATIONAL REFORM 14 (1983) ("In our view, formal schooling in youth is the essential foundation for learning throughout one's life."); see also ELCHANAN COHN & TERRY G. GESKE, THE ECONOMICS OF EDUCATION 38 (3d ed. 1990) (returns from elementary education may be higher than usually estimated because a portion of the returns from higher education may be due to the completion of primary schooling). Second, educating children is more cost-effective than educating adults because child labor laws, which establish a minimum age at which a person can be legally employed, ensure that the opportunity costs of devoting time to learning are less for children than for adults. COHN, supra note 6, at 94 (children below legal age of employment do not forgo earnings when in school). Evidence that the rate of return on education is higher in early years also suggests that failing to invest in minors' human capital imposes higher social costs than does failing to invest in adults. See BECKER, supra note 4, at 5 (finding that average rate of return on college education is between 11% and 13%, with higher rates for high school education and still higher rates for elementary school education).

13. Indeed, Adam Smith recognized the significance of human capital investment in 1776. COHN, supra note 6, at 19.

14. See, e.g., COHN & GESKE, supra note 12, at 37-38 (noting the argument but questioning whether the external benefits are significant); RICHARD G. LIPSEY & PETER OTTO STEINER, ECONOMICS 487 (4th ed. 1975) (noting the argument but questioning whether external benefits are large enough to justify government subsidy of education).

15. See, e.g., BECKER, supra note 4, at 11; cf. POSNER, supra note 1, at 138 ("[T]he costs of borrowing against a highly uncertain future stream of earnings, and also the difficulty . . . of collateralizing a loan against a person's earning capacity . . . make such loans an infeasible method of financing."); STIGLITZ, supra note 6, at 309, 317 (suggesting that primary source of market failure in education is imperfect borrowing market and noting that because most private lenders are unwilling to lend to finance education, those without funds of their own require government assistance in order to have access to higher education). Some commentators have also examined potential market failure due to the income tax system's refusal to allow persons who invest in human—rather than physical—capital to deduct the expense of human capital investments from their income. See generally Paul B. Stephan, III, Federal Income Taxation and Human Capital, 70 VA. L. REV. 1357 (1984).
I. Children as Investors in Their Own Human Capital

The most conspicuous beneficiaries of investing in children's human capital are children. Thus, a natural starting place for inquiring into the economics of human capital investment is examining the likely outcome of relying upon children to invest in themselves. Economic analysis suggests that a world in which children were responsible for their own education and socialization would be subject to at least two forms of market failure.

The first and perhaps most self-evident source of market failure is the fact that (at least from an adult's perspective) children are not rational maximizers. Self-interest should prompt rational individuals to invest in their productive capacity until the marginal rewards of greater future income equal the marginal cost of additional training and education. But minors frequently fail to pursue what they would, as adults, regard as their own best interests. Poor information may contribute to this failure. Young children lack the life experience necessary to appreciate the future returns of a present investment in human capital. A more significant factor, however, may be children's cognitive limitations. Most children have only a very limited ability to defer gratification. This presents an almost insurmountable obstacle to investment of any sort, as investment by definition requires the investor to sacrifice in the present in order to reap a greater future gain.

Such informational and cognitive limitations make children unlikely to invest optimally in their own human capital. Few children, for example, would attend school regularly without state or parental coercion, and fewer still would be willing to pay for schooling. Commentators address-

16. The U.S. legal system recognizes that children are not rational maximizers in a host of legal rules that require minors to live in the custody of a parent or other legal guardian, restrict minors' capacity to enter binding contracts, deny minors the right to vote, and so forth.

17. The observation that the same individual may have different preferences for investment as a child and as an adult raises interesting philosophical questions about which set of preferences should be regarded as the individual's "true" preferences. The fact that education can change preferences complicates the issue still further. This essay simply assumes, as a normative matter, that the operative set of preferences are those of an educated adult.

18. Many developmental psychologists believe that children do not think in abstract terms until adolescence. See, e.g., Lawrence B. Schiamburg, Human Development 28, 38 (2d ed. 1985) (discussing Piaget's and Erikson's theories of child development). Children are consequently unable to appreciate fully the concept of future gains and to sacrifice currently in order to achieve such gains.

19. Of course, lack of wealth might also prevent minors from investing in their own human capital. See infra note 31 (discussing effects of parental wealth on human capital investment). Because the young tend to have less wealth, wealth effects might be an even greater impediment to optimal investment in children's human capital if minors were responsible for purchasing their own educations, rather than their parents or society being responsible.
ing the question of human capital investment often find it so self-evident that children will not invest substantially in their own productive capacity that they fail to even address that possibility. Yet this source of market failure sets the stage for all further discussion of human capital investment. Present technology does not permit us to instantly transform young children into rational economic actors. If society is to invest optimally in the human capital of children, someone other than children must make the investment decision.

Relying on children to arrange for their own education and socialization raises another, more subtle market failure problem. Even assuming that children are rational maximizers capable of recognizing and pursuing their own best interests, an individual child's interests may not necessarily coincide with society's interests. It is possible for a child to invest in an "education" that increases her expected future well-being without increasing society's overall expected level of well-being.

The discontinuity between personal gain and societal gain arises because individuals can acquire wealth without necessarily contributing anything valuable to society. One can accumulate wealth by creating it—by producing goods and services that others value—but one can also acquire wealth simply by taking it from other, more productive individuals. Individuals can take wealth from others through many means, both legal and illegal, including violence, fraud, the exercise of monopoly power, and relying on state-sponsored entitlement programs. Thus the burglar or welfare recipient may enjoy an income comparable to that of a grocery check-out clerk without actually producing anything of value for society. That many individuals rely on wealth transfers for income is evidenced by the fact that in 1989, over six percent of adults in the United States received aid under either the Aid to Families with Dependent Children

20. See, e.g., POSNER, supra note 1, at 137-38 (discussing only parents and the state as investors in children's human capital).
21. Indeed, furthering rationality is one of the principal purposes of education.
22. For example, a child might invest in learning how to steal without getting caught. The acquisition of skills that enable an individual to take wealth from others is not, strictly speaking, an investment in human capital. See supra text accompanying note 4 (defining human capital). While the person who is skilled at taking wealth from others may herself escape poverty, society as a whole is left worse off when individuals choose to thrive through predatory rather than productive practices. See supra note 7 (discussing social effects of wealth transfers).
23. In 1991 the average welfare recipient received $7471 annually in payments under the Food Stamp and Aid to Families with Dependent Children (AFDC) programs. Jason DeParle, Why Marginal Changes Don't Rescue the Welfare System, N.Y. TIMES, Mar. 1, 1992, § 4, at 3 (table). An employee who worked 50 forty-hour weeks at the national minimum wage of $4.25 would have made $8500.
(AFDC) program or the Federal Supplemental Security Income (SSI) program.\textsuperscript{24}

Opportunities to extract wealth through transfers, rather than by producing goods and services, reduce incentives to invest in human capital as well as reducing incentives for gainful employment. Absent altruism, the social benefits from a child's selection of productive strategies for accumulating wealth over nonproductive strategies are externalities that may not figure in the child's decision how to invest her resources.\textsuperscript{25} Thus, some children may neglect formal training in productive skills such as reading or math in the expectation that they can rely instead upon wealth transfers for income.

Legal rules criminalizing fraud and theft may guard against the grosser forms of wealth transfers, but so long as those rules are enforced imperfectly, or other forms of wealth transfers remain legal, disincentives persist for children to invest in their own productivity. Social altruism may motivate many minors (as it motivates many adults) strongly to prefer acquiring wealth through productive employment. Such children will be more willing to invest time and money in their own human capital. Even among adults, however, many individuals choose to rely on wealth transfers for sustenance.\textsuperscript{26} And to the extent that social altruism is learned rather than innate, children may be less willing than adults to sacrifice and invest in their own human capital in order to avoid relying on wealth transfers.

In sum, economic analysis of children's decisions to invest in their own human capital suggests that, left to their own devices, minors would likely invest too little. Society must, therefore, adopt an approach other than relying on children if it is to ensure optimal investment in children's human capital.

\textsuperscript{24} U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1991, at 372 (11th ed. 1991) (tbl. 614). A significant portion of the population may also supplement its wealth through illegal transfers. See id. at 181 (tbl. 28) (5088 reported property crimes for each 100,000 in the population in 1990).

\textsuperscript{25} A related argument focuses on the possibility that education produces external social benefits such as better informed voters, more interesting neighbors, or other social benefits not captured in higher wages. Because those social benefits are external to the individual's investment decision, individuals purchase too little education. Thus, some commentators argue that society should subsidize education. POSNER, supra note 1, at 138 n.2 (a reason given for subsidizing education is that educated people may produce external benefits). But see COHN & GESKE, supra note 12, at 37-38 (questioning size and distribution of external benefits); LIPSEY & STEINER, supra note 14, at 487 (questioning whether the external benefits are large enough to justify a subsidy); STIGLITZ, supra note 6, at 308 (given the large private returns from education, the case for government subsidy based on externalities argument is at best unproved).

\textsuperscript{26} See supra note 24 and accompanying text (incidence of property crimes and public assistance). The use of the verb "choose" is not intended to suggest that any individual's alternatives to relying on wealth transfers are necessarily attractive.
II. PARENTS AS INVESTORS IN THEIR CHILDREN'S HUMAN CAPITAL

An alternative to relying on children to direct their own lives and make their own investment decisions is authorizing another party to make those decisions for them. The U.S. legal system often assigns such a role to children's parents. The law views parents as fiduciaries charged with protecting the interests of their children. Unfortunately, economic analysis of parents' incentives suggests that underinvestment in human capital is likely to persist in a society that relies entirely on parents to invest in their children's futures.

Absent bonding mechanisms to keep them faithful, parents, like other fiduciaries, may neglect their beneficiaries' interests in favor of pursuing their own. Legal rules against child neglect give parents incentive to provide minimal care for their offspring. But beyond legally mandated base levels of care, the primary motivation for parents investing in their children's well-being appears to be altruism.

Parental altruism toward offspring, while both a common and a powerful phenomenon, is likely to be insufficient to ensure optimal investment in children's human capital. An unfortunate and difficult truth is that parents do not always put their children's interests on par with their own. The most disturbing example is parents who physically abuse or neglect their children. Such mistreatment is distressingly common; an estimated 2.7 million children were physically, mentally, or sexually abused by their parents in 1991. The problem of imperfect altruism arises not only in such extreme cases but also whenever a parent fails to pursue her child's interests as diligently as she pursues her own. Thus, for example, the parent who spends $1.00 of her wealth on her own consumption rather than investing it in training that would increase the present value of her child's expected future income by $1.01 has inefficiently sacrificed her child's interests in favor of her own.

The fact that parents may be imperfect fiduciaries for their children does not suggest that parents do not love their children or never make personal sacrifices to further their children's interests. The point is that parental altruism often is imperfect. For example, a parent might will-
ingly sacrifice $1.00 of present consumption in order to increase the present value of her child's future earnings by $2.00, but might refuse to sacrifice $1.00 of present consumption to increase her child's future earnings by $1.10. To the extent that parental altruism is imperfect, the benefits children derive from investment in their human capital by their parents remain at least, in part, external to their parents' decisions. Thus, parents who bear the full costs of investing in their children's human capital but do not reap the full benefits will not invest to the point at which the marginal benefit of spending another dollar on investment (including all benefit to the child) equals the marginal cost. 31

That most developed nations require parents to educate their children and provide free public education is indirect evidence that most people do not regard parents (at least other children's parents) as perfectly reliable representatives of their offspring's interests for purposes of deciding how much to invest in their human capital. If parental altruism were perfect, parents would willingly pay for or otherwise provide private schooling whenever the costs of doing so were outweighed by their children's greater gain. Public education implicitly assumes that absent state intervention, many parents would invest too little in their offspring's education. 32

Just as one might view parents as their children's fiduciaries, one might also envision parents as agents of the larger society who socialize children by directing them towards wealth-creating, rather than wealth-transfer-
ring, activities.\textsuperscript{33} But just as parental altruism towards children may be imperfect, parental altruism towards the larger society may also be imperfect. Some parents may be willing to sacrifice to allow their children to acquire the productive skills and habits necessary to pursue wealth-creating over wealth-transferring life strategies. On the other hand, at least some parents may be content to allow their children to subsist by taking existing wealth from others. While perhaps more prone to social altruism than children,\textsuperscript{34} adults are hardly perfect social altruists. Certainly one may reasonably suspect that a parent who is herself a burglar or public aid recipient may regard earned wealth and transferred wealth as close substitutes. Once again, to the extent that parents fail to take account of the social costs of their children relying on wealth transfers rather than productive skills, parents will underinvest in their children's human capital.

The observation that parents may be less than perfect fiduciaries for both their children and society suggests that, at least in theory, legal rules that bond parents' interests more closely to their children's or to society's might correct parents' tendency to invest too little in their children's human capital. One can imagine tort rules that make parents who inadequately educate their children liable for their reduced future earnings, or impose liability if offspring rely on wealth transfers rather than productive employment. Unfortunately, even if such radical legal change were politically feasible, the tertiary costs of such rules would likely be enormous.\textsuperscript{35}

Another approach to remedying parental underinvestment in children might be to focus on enhancing and strengthening the tenuous bonds of altruism. For example, state-sponsored parent education programs might be designed to educate and motivate parents in the care and nurturing of their offspring.\textsuperscript{36} The state might also attempt to encourage altruism indirectly, by discouraging individuals who may be less inclined (whether by nature or circumstances) to make sacrifices in favor of their offspring from bearing children in the first place. An example of the latter approach might be government programs to encourage and subsidize contraception. Approximately one-third of children born in the United States are con-

\begin{footnotesize}
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\item See supra text accompanying notes 22-26 (discussing transfers).
\item See supra text accompanying note 26 (discussing altruism as learned behavior).
\item Guido Calabresi has used the phrase "tertiary costs" to refer to the administrative costs of recognizing and enforcing liability rules. See Guido Calabresi, The Costs of Accidents: A Legal and Economic Analysis 225 (1970). Liability rules that make parents liable for their children's reduced future productivity would impose large tertiary costs because recognizing such causes of action would create potential claims on behalf of virtually every member of society.
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ceived unintentionally. If parents who affirmatively desire and plan their children are more prone to altruism than those who conceive accidentally, greater use of contraception might result in greater average investment in the human capital of those children who are born.

On the whole, however, even though government intervention might improve parents' willingness and abilities to act as altruistic fiduciaries, such intervention seems unlikely to make parents perfect fiduciaries for their children or for society. Underinvestment and misinvestment in children's human capital are likely to persist in a society that relies entirely upon parents to see to their children's education and training.

III. STATE INVESTMENT IN CHILDREN'S HUMAN CAPITAL

The analysis presented above suggests that, left to their own devices, neither children nor their parents would invest an optimal amount of resources in children's human capital. A laissez-faire approach to child education and training consequently would appear to encourage inefficient underinvestment that increases the incidence of poverty. State regulation to encourage greater investment in children's human capital can improve the welfare of all, including the poor.

State intervention in the decision to invest in children's human capital is in fact a common pattern. Most developed nations require children to attend school and provide free public schooling that follows a state-determined curriculum emphasizing productive skills (reading) over wealth-transferring skills (burglary). Such arrangements presume that neither children nor their parents can be relied upon to invest optimal amounts in children's human capital, or to ensure that investment is directed towards acquiring productive rather than wealth-transferring skills.

Yet, the widespread availability of public schools should not be accepted as conclusive evidence that government routinely or adequately corrects for the market failures likely to prevent unregulated individuals from investing optimally in children's human capital. At least in the United States, the popular perception that America's public schools are failing

37. Id. at 148 (35.3% of births in 1988 were unintended).
38. See Posner, supra note 1, at 138 n.1 (noting that some children are undesired byproducts of sexual activity and implying that parents of such children may be less altruistic).
39. Cf. Sawhill, supra note 36, at 175-79 (discussing possibility of improving child welfare by discouraging teenage childbearing). But cf. Posner, supra note 1, at 138 n.1 (because contraception increases the incidence of sexual activity, it may be that while the proportion of unwanted births to sexually active adults decreases, the number is the same).
40. As one commentator has observed, "Some parents fail to provide adequate nurture, discipline, and moral education to their children, but it is not clear what government can or should do about the problem." Sawhill, supra note 36, at 174-75.
their students counsels against complacency. Merely investing in children is not sufficient; the state must invest enough and must invest wisely.

While public education encourages more investment in children's human capital than would occur under a laissez-faire regime, the variant of economic theory known as social choice analysis suggests that the amount of public resources devoted to developing the productive skills of America's children still falls below the efficient level. Social choice theory applies the rational maximizer paradigm that traditional microeconomics applies to the individuals who make up markets to the individuals and groups who constitute political systems. A cursory social choice examination of public education in the United States suggests at least two forms of political "market failure" likely to prevent society from investing sufficiently in children's human capital.

A primary obstacle to optimal social investment in children is the fact that the principal beneficiaries of such investment are disenfranchised. Investing in children's human capital on a pay-as-you-go basis requires present voters to sacrifice in order to increase the returns enjoyed by a future generation. Unfortunately, that future generation lacks voting power at the time the decision to invest must be made.

41. See, e.g., Segal et al., supra note 8, at 70 (arguing that most Americans believe public schools are not adequate, and the business community views most high school graduates as lacking basic skills).

42. Many commentators suggest that the public funds devoted to child education and training in the United States are not used efficiently, and that systemic reforms might permit greater returns on present levels of investment. See supra note 5 (discussing reasons why public funds earmarked for human capital investment might not be spent wisely). The fact that funds earmarked for children's human capital may be misspent is consistent with the view that our society devotes insufficient resources to its children, including devoting too little time and attention to ensuring that funds spent on children are spent efficiently.

43. See generally DENNIS C. MUELLER, PUBLIC CHOICE II (1989).

44. This essay focuses on the social choice problems posed by future generations' disenfranchisement and by local financing. See infra text accompanying notes 45-46 (disenfranchisement) & 47-50 (local financing). However, social choice theory suggests other obstacles to optimal social investment in children. For example, organized interest groups may exert undue influence over the uses of funds earmarked for children. See supra note 5; see generally MUELLER, supra note 43 (discussing interest group theory). Disagreement among society's members over the best means of investing in children's human capital poses another problem: Arrow's Theorem suggests that when a group's members have differing preferences, voting may not necessarily select the outcome that maximizes society's well-being.

45. See generally POSNER, supra note 1, at 461-62 (discussing conflict of interest between generations inherent in savings and investment policies). Investment policy raises questions of equity between generations as well. Even if investment could produce substantial returns for future generations, if it requires a relatively poor present generation to make severe sacrifices in order to make an already wealthier future generation even better off, some might object to investment on distributional grounds. Contractarian political theory offers one possible solution by suggesting that rational maximizers who do not know to which
To some extent, members of the present generation of taxpayers may be willing to invest in the human capital of the next because they anticipate some personal benefit from doing so. For example, the parent of a school-age child may perceive public schools as a substitute for private schooling she would otherwise purchase altruistically for her offspring. Even a childless taxpayer might be willing to contribute towards the education of other people's children if doing so would help those children become productive adults who would pay the payroll and income taxes necessary to finance programs from which the taxpayer hopes to benefit in the future, such as Social Security or Medicaid. To a large extent, however, the benefits of investing in future generations accrue only to those latter generations. Unless the present generation displays perfect altruism towards the next, it will regard many of the benefits of investing in children as externalities, and will be unwilling to pay for them.

Designing a political system that adequately represents the interests of subsequent generations, some as yet unborn, presents obvious difficulties. A social choice analysis nevertheless suggests some political procedures that may reduce the inefficient underinvestment likely to result from future generations' political voicelessness. For example, disincentives to invest in children's human capital can be reduced if the present generation of voters can shift at least part of the costs of investment onto the children who will benefit from that investment.46 One might imagine a society in which every individual upon reaching adulthood is presented with a bill for her primary and secondary level education. More realistically, costs can be shifted by financing public education programs through long-term government borrowing. Social choice theory consequently suggests that deficit financing, which is often regarded as inherently undesirable, may offer distinct advantages in overcoming the political market failure that leads society to invest too little in children.47 The difficulty is ensuring that funds raised through deficit financing are invested in children's human capital rather than used to subsidize the present generation's increased personal consumption. Deficit financing schemes that earmark funds for investment (such as school bond issues) might be preferable to general

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46. Successful cost shifting raises another social choice problem, however. If the present generation enjoys some benefits from investing in children's human capital but pays none of the costs, there is incentive to overinvest.

47. Deficit financing may also distribute the costs of investment more equitably between present and future generations. See supra note 45 (discussing equity between generations).
deficit financing that allows current taxpayers to consume more in government services at future generations' expense.

In addition to the difficulties posed by future generations' disenfranchisement, a second social choice obstacle to efficient public investment in children's human capital may be local financing. In the United States, state and local governments pay for the lion's share of primary and secondary education. Most critics of local financing object on the grounds that it produces inequitable spending disparities between wealthier and poorer states and school districts. Social choice theory suggests that local financing can lead to inefficient underinvestment in children as well.

In stable societies where people tend to reside in the same community throughout their lifetimes, local financing is less problematic. The rational taxpayer considering whether to invest in the community's human capital by funding public schools or other programs that invest in children can rest assured that she will have an opportunity to reap at least some of her investment's benefits in the form of better schooling for her own child or a better educated and more productive local work force.

In highly mobile societies, however, local financing invites taxpayer attempts to export the costs of human capital investment to other districts. Thus, a taxpayer in District A may be reluctant to invest in District A's children because she expects that many of them will move to other districts upon reaching adulthood, while children raised in other districts will migrate into District A. Alternatively, the taxpayer may herself move and so fail to reap her investment's benefits. In either case, in a mobile society the net result of local financing of human capital investment is to discourage investment in children's human capital by externalizing that portion of the benefits of such investment that would have been captured by the investing generation.

Local financing can be defended as allowing communities with differing tastes for investment to select customized levels of funding that reflect each community's preferences. Although real, in a highly mobile society this benefit may come at a significant efficiency cost in terms of discouraging human capital investment. Social choice theory thus suggests that an increased emphasis on federal funding of programs can help prevent underinvestment in children's education by internalizing taxpayers' expected costs and benefits from investing in human capital.

In sum, while state intervention in the decision to invest in minors' human capital would appear to hold out hope for overcoming the market failures that lead children and parents to invest too little, social choice theory suggests some significant obstacles to optimal state investment.

48. Cohn, supra note 6, at 125-58.
49. See id.
Shifting from pay-as-you-go to deficit financing, or from local to federally-based financing, can alleviate—but is generally unlikely to eliminate—inefficient underinvestment in children.

CONCLUSION

Analyzing poverty from an economic perspective offers unique insights into its causes and cures. Although this essay only scratches the surface of human capital theory, even a casual inquiry into the market for human capital investment suggests that persistent and endemic market failure may be keeping society from devoting adequate resources to ensuring that its children mature into productive, wealth-creating adults. Investing too little in children contributes substantially to poverty because many children are denied a full opportunity to develop the skills and habits necessary to earn high wages. Conversely, encouraging investment in children can increase the expected future wealth of both those children and society as a whole.

Economic analysis consequently suggests that at least some poverty might be avoided if disincentives that presently discourage parents, children, and governments from investing in children could be overcome. And because investing in individuals' productivity ultimately benefits the well-to-do as well as the poor, reform policies emphasizing human capital investment may enjoy greater political support than wealth-transfer policies that require the well-off to sacrifice without the promise of some corresponding gain. On a more pessimistic note, however, economic analysis also suggests that the obstacles to optimal social investment in children are both more subtle and more pervasive than generally assumed. Society invests too little not because it lacks wisdom or will, but because the market for children's human capital suffers grave defects that relentlessly promote chronic underinvestment. School voucher programs, national testing, and similar proposed reforms cannot resolve the underlying dilemma of political and economic market failure.

50. Redistribution may, however, increase utility if individuals have declining marginal utility for wealth. Posner, supra note 1, at 434-36.