Returns to Education: a Household Welfare Approach

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The concept of human capital dates back to the founding of Economics by Adam Smith. Unlike physical capital, human capital does not face diminishing returns and can be the engine of continued growth in an economy. Arguably, the most important channel of human capital accumulation is through the receiving of education. However, quality education in modern days do not come cheap. To make matters worse, private credit markets are reluctant to fund investments in human capital as it is an all-or-nothing gamble for the lender – it is simply not possible to post a human agent as a collateral. As a result, the responsibility of providing access to education falls largely on the government. Using Indonesia as a case study, the returns to education are examined. It is discovered that in addition to a signicant increase in individual income, gaining access to education permanently alters household consumption patterns and has the potential to boost household welfare.