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New Evidence That College is a Risky Investment

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By Richard Vedder

Many published studies argue that higher education as a private investment yields a high rate of return—10 percent is a commonly cited figure. It is argued that you can do much better investing in higher education than in, say, real estate, stocks, or bonds. I have always been very skeptical of these studies, and two new papers support my view.

I have been saying for years that there is a huge risk that new college entrants will drop out, and that published academic studies usually implicitly look at those who graduate, ignoring a roughly equal number who fail to graduate from college in a timely manner. That is the huge flaw in the *Does College Pay?* studies annually produced by Sandy Baum for the College Board.

Now two studies, both presented at the American Economic Association meetings in Denver last week, make the same point. In "College Risk and Return," Gonzalo Castex suggests a large part of the extraordinary (above normal) returns of college are explainable by the compensation needed for risk-averse persons to take the risks of going to college—the risk they might not make it through. Roughly the same thing is argued, albeit a bit differently, by Kartik Athreya and Janice Eberly in "The Education Risk Premium."

When the return on something is high, investors flock to it, eventually reducing the return to a more "normal" return. Thus when Apple seemed to be making millions of new profits from the hugely popular iPad, dozens of imitators appeared with tablet devices—within months. But seemingly that phenomenon has not happened in higher education—enrollments have risen, but rather sluggishly, and not enough, it would seem, to increase the supply of college graduates enough to depress their average wage and thus the return on college investments.

The reason is that in some risk-adjusted sense, the return to higher education is NOT that unusually high, since the risks associated with "buying" an education are actually greater than buying, say, stock in Procter & Gamble: The probability of essentially losing the investment (by failure to graduate) is greater in higher education than in blue-chip stocks or certainly bonds.

Other evidence suggests that we may be entering an age where the risk-adjusted return on higher education, actually near that of other investments in the past, may be falling below the gains from these alternative opportunities. Tuition fees continue to rise sharply relative to the incomes of college graduates. More college graduates are taking low-paying jobs, say as waiters or cashiers in stores.

As former Spellings Commission chair Charles Miller reminded me the other day, if we reduce the price of higher education through productivity-enhancing changes in higher education, the rate of return will rise. Lower-than-normal returns in higher education can be remedied two ways: by reducing costs (and thus the size of the investment) or by increasing the wage premium associated with college by restricting the supply of growth of new college graduates. Or both.

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