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College risk and return

Gonzalo Castex

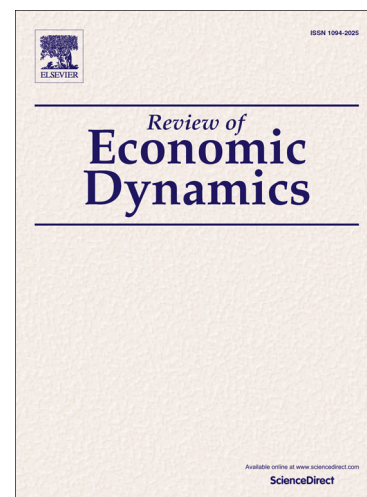
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College Risk and Return[☆]Gonzalo Castex¹*Central Bank of Chile
Agustinas 1180, Santiago*

Abstract

A large number of studies report high returns to college education. However, a large fraction of high school graduates do not pursue higher education. To reconcile these facts, I develop a heterogeneous-agent life-cycle model with endogenous college enrollment and uninsurable risk of college completion. The risk of failing to complete college explains 14% (18%) of returns to a 4-year (2-year) college. Risk premium varies with individual ability and family income. Using the model, I analyze how costs and benefits of college education affect enrollments and dropouts. Model predictions are consistent with trends in enrollment and dropout observed in the data and findings in related literature.

Keywords: College attendance, Risk premium, Return to education, College dropout

1. Introduction

A large amount of research has been devoted to evaluating the payoffs of higher education. Numerous studies show that investments in an individual's human capital leads to better labor market outcomes. Educated workers earn
5 more and this wage differential has been persistent over time (Goldin and Katz,

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¹gcastex@bcentral.cl

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