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Carolina Arteaga



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The Effect of Human Capital on Earnings: Evidence from a Reform at Colombia's Top University

Carolina Arteaga¹
UCLA

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In this paper I test whether the return to college education is the result of human capital accumulation or instead reflects the fact that attending college signals higher ability to employers. I exploit a reform at Universidad de los Andes, which in 2006 reduced the amount of coursework required to earn degrees in economics and business by 20% and 14%, respectively, but did not change the quality of incoming or graduating students. The size of the entering class, their average high school exit exam scores, and graduation rates were not affected by the reform, indicating that selection of students into the degrees remained the same. Using administrative data on wages and college attendance, I estimate that wages fell by approximately 16% in economics and 13% in business. These results suggest that human capital plays an important role in the determination of wages and reject a pure signaling model. Surveying employers, I find that the reduction in wages may have resulted from a decline in performance during the recruitment process, which led students to be placed in lower-quality firms. Using data from the recruitment process for economists at the Central Bank of Colombia, I find that the reform reduced the probability of Los Andes graduates' being hired by 17 percentage points.

JEL Classification: I23, I25, I26, J24, J31.

Keywords: Education, human capital, signaling.

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