

Intelligent Money

Current thinking from Haven Financial Advisors

Does it Pay to Go to College?



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Special Notes of Interest:

The Department of Labor revealed in its May 2014 employment report that USA finally recovered the jobs lost in the Great Recession.

The number of working age Americans increased by 1.2% per year in the 1990s. That rate has fallen to 0.4% in 2013

Almost two thirds of 2013's high school graduating class is attending college now. One of the key financial goals of many American families is to pay all or most of their children's college costs. It's a major investment, the value of which has come under increasing scrutiny. The price of a college education and the attendant debt taken on to pay for it has mushroomed. This edition of *Intelligent Money* will look at some of the factors weighing on the value of higher education.

College Education: The Big Picture

There is little doubt, statistically, that college can deliver long term economic benefit. Graduates of four year colleges earn at least 85% more than the balance of the population according to a variety of sources. And the gap is increasing. The college advantage was 55% to 65% forty years ago.

The measured effect is broad. The gap between the wages of the baccalaureate holder and the rest has increased in virtually every other developed country in the last 30 years. Associates degrees from two year programs also deliver value. A [just-released study](#) by the Federal Reserve indicates that graduates of associates programs earn a substantial premium

to high school graduates with much lower out-of-pocket costs.

As the chart below illustrates, college graduates of both sexes have out earned their peers for decades. This earnings gap has persisted even as the proportion of college graduates in the labor force increased. The demand for higher education appears robust. Case closed?

Something's Missing

The broad brush data clearly endorses the merits of formal education. Yet there is no single college degree. There are a multitude of institutions of higher learning as well as a wide range of scholastic aptitudes for those that attend.

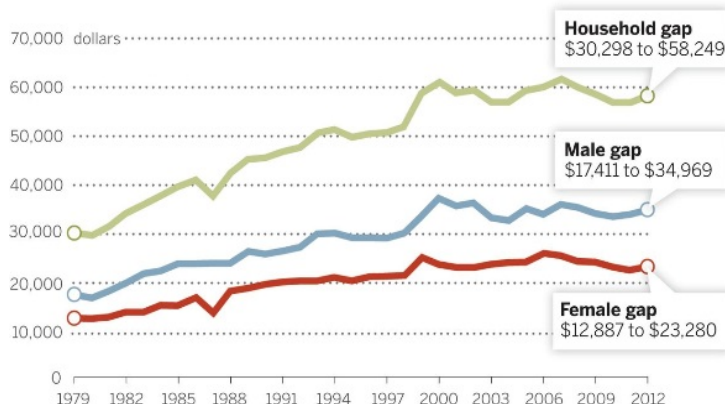
There is some evidence that America's higher education is bloated in certain areas while underserving others. There is no clear consensus as to its shortcomings but there are some troubling details in the data.

Many college graduates are significantly underemployed. Of course, recent graduates have always had some difficulties transitioning to long term employment commensurate with their skills. However, evidence from recent decades indicates that a greater

College/high school median annual earnings gap, 1979–2012

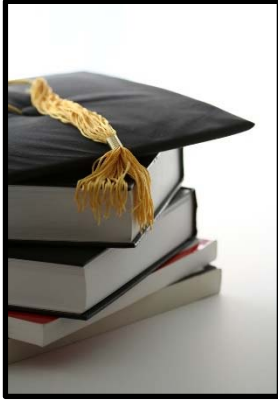
In constant 2012 dollars

1 Source: David Autor, *Journal of Science* 2014



fraction of graduates are either working at [low paying jobs or are working part time](#). Some examples of jobs not associated with college are taxi drivers, retail salesman, bank tellers, and firefighters. There were almost no college graduates in these jobs in 1970. Now, about [15% of those positions are staffed by them](#).

Another troubling statistic is that 40% of the attendees at four colleges never obtain a degree. These individuals undertook a portion of the direct and opportunity costs of college



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attendance but did not reap the signature benefits of a degree. Those that drop out waste their own and often public resources. The earnings premiums associated with college attendance do not factor in the dropout rate.

Another confounding factor is the difficulty in separating the actual benefits of the college education from underlying differences in abilities of those attaining a degree. As a general rule, smarter people graduate from college and those folks tend to succeed in their careers later in life. To some extent, college is a rather expensive signal that its graduate is reasonably intelligent and can follow a curriculum for four years.

There is also some question as to whether college curriculums are meeting the demands of the nation’s employers. Is there a “skills gap” in the US employment market? If college is generating too many graduates without the skills that the economy demands, we might see lots of high paying jobs go unfilled.

There is considerable debate on this topic of the skills gap. Many economists believe that the primary driver of job woes in this country is a decline in aggregate demand. However, most concede that there are least pockets of persistent skill shortages which are hampering employment. In their 2011 [survey](#) on challenges facing the manufacturing sector, Deloitte and the Manufacturing Institute found that about 650,000 high paying positions in the manufacturing sector alone went unfilled while the nation’s headline unemployment remained above 9%. The majority of the survey respondents believed that this skill shortage would become more severe in the future.

Even as the ranks of American colleges swell, the people hiring – the boots on the ground – remained skeptical of the product that colleges were delivering. Thus far, we’ve discussed the outcomes of a college education. It’s important also to address the issue of financing in some detail. As we’ll see, the financing of higher education is everybody’s business.

Financing a College Education

College tuition now averages more than \$30,000 per year at a private university, \$22,000 per year at a public school for out-of-state students, and \$8900 for in-state students. The rate of the price increase in recent decades has been very high. Over the last 30 years, tuition and fees at both four year and

two year institutions have quadrupled, *after accounting for inflation!*

Yet comparatively few students pay the sticker prices upon which the foregoing calculations are based. [Grant aid and tax benefits have defrayed](#) a growing share of college costs. Twenty years ago, grants and tax benefits offset a bit less than half the cost of tuition and fees at public universities. Now, almost two thirds are offset. Over 57% of tuition and fees at private institutions are offset by grants and tax breaks. From the standpoint of the consumer, some of the “sticker shock” has been reduced.

The federal government has become a major player in financing the higher education industry. The commitment began in 1965 with the Higher Education Act. Today aid to education takes the form of tax breaks, grants, and guaranteed student loans.

The CBO estimates that the cost of government subsidized loans initiated this year will [be \\$21 billion](#). That represents the cost of the subsidy. Aggregate college debt now exceeds \$1 *trillion*—more than cumulative credit card debt—and represents three times what students owed a decade ago.

The US government’s Pell Grant program costs [about \\$33 billion](#). Annual tax benefits for college expenses are about [\\$36 billion](#). The scale of these programs has expanded greatly over the past decade. Third party payers like Uncle Sam make buyers (students and their parents) less sensitive to price. Sound like health care? The overwhelming majority of medical costs are borne by public and private insurers – third party payers. That’s another industry that has experienced runaway price inflation.

These subsidies shift the cost burden away from those who directly benefit to the rest of the population. The non college bound population is the very group that is least able to shoulder this financial burden. That doesn’t seem fair.

Market distortions from government subsidy are most apparent in the for-profit education area. Over 80 percent of the revenue of the for-profits comes from federal loans and grants. The student loan default rate for those attending for profit institutions reaches almost 22% within three years, compared with 10.8 percent at public colleges and 7.6 percent at private nonprofit institutions, according to recently released data from the [Education Department](#). Graduation rates at for profit schools are well under 50%. Those are NOT good numbers!



“ Only 62% of college graduates actually work in a job requiring a college degree.”

For profit schools were an insignificant slice of the education market at the turn of the century with just 366,000 students enrolled. Now, 11% of the nation’s students enrolled at four year colleges are attending for profit institutions. Enrollment peaked 1.63 million in 2011.

The overall rate of student loan defaults has been creeping upwards since the 1990s, even as college graduates as a whole seem to be doing better. At a minimum, it would seem that there are some serious misallocations of resources in the education sector. The chart below illustrates the big picture with student loans.

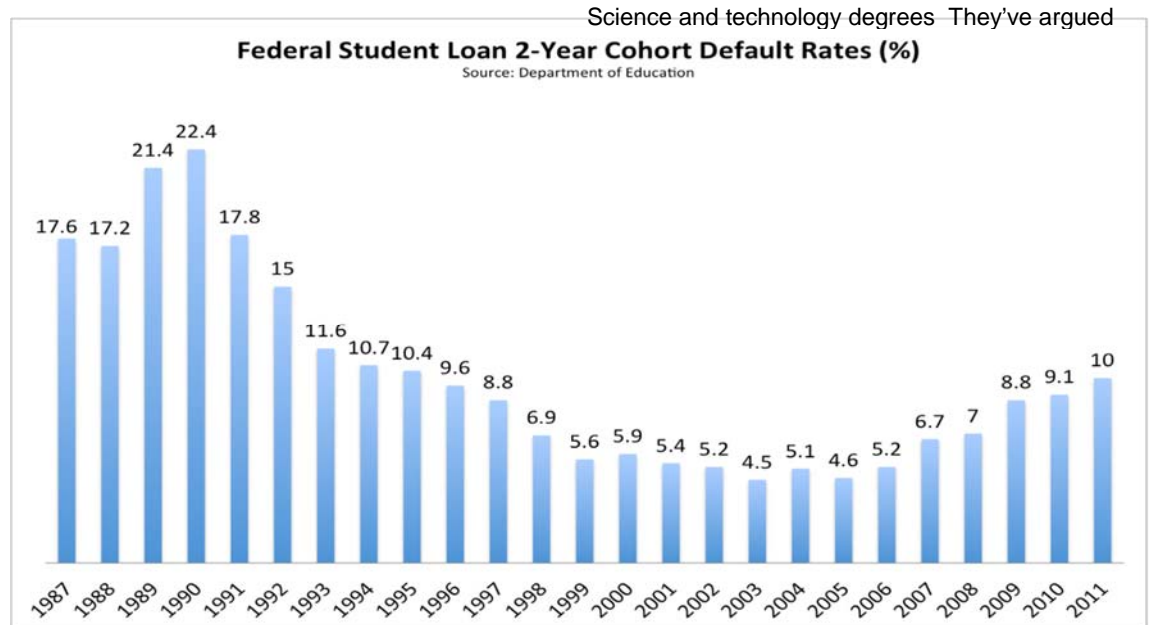
Conclusions

No one disputes that America’s college education system, taken as a whole, delivers tremendous value. There are signs, however,

that it is too big ... or at least growing too much in the wrong direction. Only 62% of college graduates actually work in a job requiring a college degree. And about a third of young college graduates questioned the financial value of their college education in a recent survey by Wells Fargo.

Perhaps employers need to take some responsibility for training the nation’s youth. This is especially true in the high tech and medical fields. They are the first direct beneficiaries of a properly aligned educational system.

Federal and State governments should consider scaling back their massive subsidies of the traditional education process. These subsidies might be more effective if they targeted science or technology sectors, areas where there is a more direct payoff to the student and society.



Suggestions for additional reading

Jaison R. Abel and Richard Deitz, [Do the Benefits of College Still Outweigh the Costs?](#) *Federal Reserve Bank of New York: Current Issues in Economics and Finance*, Volume 20, Number 3 2014

Jaison R. Abel, Richard Deitz, and Yaqin Su, [Are Recent College Graduates Finding Good Jobs?](#) *Federal Reserve Bank of New York: Current Issues in Economics and Finance*, Volume 20, Number 1 2014

Richard Vedder, Christopher Denhart, and Jonathan Robe, [Why Are Recent College Graduates Underemployed?](#) A policy paper from the Center for College Affordability and Productivity, January 2013

The Manufacturing Institute: [2011 Skills Gap Report](#)

The College Board: [Trends in College Pricing, 2013](#)

Federal Education Budget Project: [Federal Student Loan Cost Estimates](#)

Michelle Camacho Liu, [Do for profit schools pass the test?](#) June 2011, National Conference of State Legislatures.