

# SCHOOLING AS A SIGNAL

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"Edu does not increase productivity but serves as a signal on worker's ability = productivity"

• Imagine Low productivity people  $q$  200 (population)  
 high —————  $1 - q$  300  
 productivity is innate from birth

• employer does not know H or L

• L would lie about himself claiming H

• in absence of info employer pays average

salary  $\bar{y} = q \times 200 + (1 - q) \times 300 = \underline{300 - 100q}$

Pooling equilibrium

- L people like it

- H ——— do not like it

- employers do not like because  
 cannot properly allocate workers  
 to jobs  $\rightarrow$   $\downarrow$  output  $\rightarrow \pi \dots \rightarrow$   
 $\rightarrow$  lowering  $y_H$

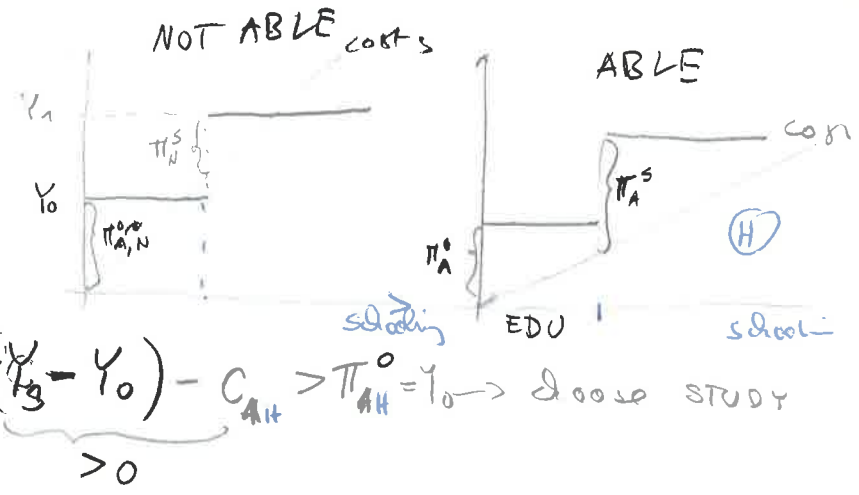
want  
 separation-  
 equilibrium

incentive to provide  
 credible information

SIGNAL (H)

• Education — can serve as a signal under some  
 conditions - if it is more costly to (L) people

Able  $C_H < Y_S - Y_0$   
 Not Able  $C_L > Y_S - Y_0$



ABLE no schooling  $\pi_H^0 = Y_0$   
 schooling  $\pi_H^S = Y_0 + (Y_S - Y_0) - C_{AH} > \pi_H^0 = Y_0 \rightarrow$  choose study

NOT ABLE no schooling  $\pi_L^0 = Y_0$   
 schooling  $\pi_L^S = Y_0 + (Y_S - Y_0) - C_{AL} < \pi_L^0$  do not study

Perfectly SEPARATING SIGNALING EQUIL. OCCURS

CONCLUSIONS • schooling is not increasing productivity but separates people by innate productivity

- schooling system is costly system of signaling
- sheepskin effect: sheepskin level of education - signals to employers

How to DIST. ... ?

- if true: education has positive private returns, zero social returns → wasteful
- if ~~true~~ positive matching role of signaling & highly ~~the~~ productive workers are allocated into skilled jobs => impact on national income. Magnitude is still a question

## TO DISENTANGLE?

- We need variation - in EDU - RANDOM
- drop-outs have systematically lower ability
- changes in institutions