Commencement Address

Narayana Kocherlakota

President
Federal Reserve Bank of Minneapolis

College of Liberal Arts

University of Minnesota

Minneapolis, Minnesota

May 16, 2010

Congratulations! You have earned your college degree. Now, I'm sure that I'm not the first to congratulate you. Your parents have congratulated you. Your aunt and uncle have congratulated you. In fact, if you're lucky, even your teen-age brother or sister has found the time in their busy lives to congratulate you.

Why does everyone congratulate you? I'm going to give you two answers to that question. The first is pretty uncontroversial, while the second is more so.

I first want to talk about your college degree as a successful financial investment. My guess is that most of you have not done a lot of financial investing yet. When I was in college, I liked to put my spare money into pizza and not into stocks or bonds. (Pizza pays off - but in pounds not dollars. That's a pun, and a great example of what economists call humor.) But, whether you realize it or not, going to college was an investment. Anytime you give up some money today in exchange for money in the future—well, that's an investment. And making good investments is critical to being financially successful.

Economists rank investments by what we call investment returns—that is, what you get back per dollar invested. If you give up $100,000 and get back $8,000 per year forever—well, that's a return of 8 percent per year. If you give up $200,000, and get back $8,000 per year forever—well, that's a return of 4 percent per year. The second investment is not as good as the first (assuming that they have the same levels of risk). We can compare any two investments, no matter how different they seem, by comparing their returns.

Your college education was a big investment. You—and your investment partners—gave up about $40,000 in tuition. But that's just the beginning—you couldn't work full time while in college, and so you lost out on four years of part-time wages. All told, my guess is that you gave up something on the order of $100,000.

So, the college education investment was a big one, in terms of what you put in. But you also will get something big out of that investment—higher wages upon graduation, and then higher wages for the rest of your working life. What is the expected return on investing in a college education—that is, what will you get back in terms of increased wages per dollar that you invested? Recent studies estimate that finishing college over high school delivers a return of somewhere between 8 percent and 10 percent per year.[1] Is this a big number? Well, historically, the rate of return on the stock market is around 6-7 percent per year. So, by investing in a college education, you can beat the stock market! That's especially true because the return to a college education is much less risky.

These numbers are pretty well-known. The real kicker is the value of a four-year degree over a two-year degree. You've received your degree at the University of Minnesota. You could've earned a two-year degree instead. But four years of post-high school education delivers a return of about 15-20 percent per year over two years of post-high school education. That's over twice the return to the stock market.

[1] See Table 4, Heckman, et al. (2005).

Now, there is a complicating factor to this somewhat rosy scenario that's probably occurred to all of you: We are coming out of one of the worst economic downturns since the Great Depression. Jobs are not in abundance.

Fortunately, this doesn't change the story—and that's something that I can tell you from personal experience. I graduated from college in June 1983, when the unemployment rate was actually even higher than it is today. Now it is true that when I graduated, the slack job market put downward pressure on all wages, including those of college grads. However, over time, the wages of these June 1983 grads did rise, and the negative effects of the recession were largely lost. Even in a tough job market, my cohort found that college remained a good investment.

And that's my first reason for congratulating you! You've made a great financial investment. In fact, my bet is that few of you will ever make a better one. I never have.

But I have a second reason for why you should be so happy today. It's related to a question that may have occurred to you already: If going to a four-year college is such a great deal, why don't more people get four-year college degrees?

There are a lot of possible answers to this question, including some significant issues related to credit access. However, the most important answer is also the simplest answer: Some people like college better than others. Now, I'm not saying that there are some people who like college parties and other people who don't. That's probably true, but it's not the main reason why some students invest $100K in themselves and others don't. What I'm saying is that some people enjoy learning and others don't. Those who like to learn—well, they go to college and spend four challenging years learning. Those who don't like to learn—well, they don't finish, and in many cases they don't even start.[2]

I think that this simple story - that people go to college because they like to learn - says something deep about college, and especially about a college of liberal arts. As a student, I took a lot of courses in the liberal arts. Economics, of course, but I also took courses in sociology, English legal history, American constitutional interpretation, Chaucer, art history, Asian music, and on and on.

I have to admit that I have not retained as many details as I would like from these courses—so please don't ask me about the constitutions of Clarendon or how a mob is different from a crowd. But even though I don't retain all of the details, the courses were all important to me. I learned to approach new ideas with respect. I learned to make an argument. I learned to read and think critically. Basically, I learned to learn in college—and I loved learning to learn, because I loved learning.

That's what any good college—and especially any good college of liberal arts—does. It takes people who like to learn and teaches them how to learn—not just at school but in all aspects of their lives. It is often rightly emphasized that this process is spiritually enriching. But to an economist like me, it's important to emphasize its financial benefits.

[2] See the survey of recent work in Section 10 of Heckman, et al. (2005).

College grads get higher wages in part because they have already acquired valuable skills. But college grads also get higher wages because they like learning and know how to learn. Their ability and willingness to keep learning, and thereby acquire more skills, is also what allows their wages to grow so fast over time. And this is the second reason why I say congratulations to you—you're a person who likes learning, and that's allowed you to learn how to learn.

I'm sure that you've realized over the past couple weeks that nobody over the age of 40 ever talks for ten minutes to a recent college grad without offering advice of some kind. Now you get to hear mine.

I've told you that college was a good investment for you because you're a learner. But to get most of the economic benefits from college, like the faster wage growth, you have to stay a learner for years and years and years. How do you stay a learner? To me, the answer to this question lies in confidence. You cannot learn without asking stupid questions. You cannot learn without revealing your ignorance. In other words, you cannot learn without having the confidence to make mistakes.

You've got that confidence now. It is a large part of what has led you here today. I urge you to strive to retain that confidence in the years to come. As an economist, I can tell you that it can make your income grow rapidly over time. As a person, I can tell you that it can keep you young even when all the physical signs say that you are not.

Once again, congratulations to you all!

References

Heckman, J., Lochner, L., and Todd, P., Earnings functions, rates of return, and treatment effects: The Mincer equation and beyond, National Bureau of Economic Research working paper 11544.