Chapter 9: Making Human Capital Investments Pay Off by Cutting Costs and Increasing Benefits; Just Don’t Put "M.B.A." on the Card

The essence of human capital theory, as discussed in Chapter Nine of *Modern Labor Economics* is that people make sacrifices in time, money, and effort to acquire skills that will enhance their productivity and pay off in higher earnings in the future. Given the time value of money, future earnings need to be considerably higher in order to compensate one for making payments—both in actual and in lost earnings—up front. Several recent articles in *The Wall Street Journal* examine the payoff to investments in higher education and find that they can often come up short, but offer readers some encouraging advice on how to improve one’s investment prospects.

Recall from the case study for Chapter two that market prospects for lawyers these days are mixed, with terrific starting salaries for those who land jobs with the big firms but much tougher conditions for the majority of law school graduates who don’t land those plum jobs. The author of the *The Wall Street Journal* article behind that case, Amir Efrati, offered another installment on the same subject, but this time came armed with advice.

Law school tends to be an expensive human capital investment. You virtually always have an undergraduate degree and usually have done well in earning that degree, so your opportunity costs of foregone earnings from jobs you might have taken can be quite high. Add to that the tuition for law school for three years, which can easily reach $100,000 or more, and you need to earn a much higher salary than you otherwise would have earned for a long time if the investment is to pay off. But if the high salaries are only going to a minority of the law school graduates, one of the lucky ones Efrati quotes is surely correct in saying, “Law School is definitely a huge financial mistake for a lot of people.”

So, the golden rule of investing is to buy low and sell high. How then does one do this with a legal profession? Efrati offers advise on both counts. To cut costs (buy low), he suggests reconsidering your choice of which school to attend. Unless you can get into one of the very top schools, whose graduates tend to do better independent of their grades, the cost of your school becomes a critical factor. In-state schools and public institutions tend to be significantly less expensive than out-of-state and/or private schools. Raising your payoff (selling high) provides another good reason to consider these schools, even though they may seem to be slightly less prestigious than a “name” school elsewhere. Those who graduate at or near the top of their class from lesser schools will typically have better prospects than someone graduating in the middle or bottom third of the class from a “better” school that is not in the very top tier but still has a more competitive student body. Finally, “making the realistically expected payoff an important part of your choice of schools is essential. Do plenty of research on how the students from various law schools do after graduation. Do the big firms recruit at your chosen school? What are median and average starting salaries for graduates? What is the placement rate? It won’t be easy—the schools are not necessarily going to help you find out if their students have difficulty finding high-paying jobs. But don’t bother trying to sue them for false advertising if your dream job doesn’t materialize.

Not everyone who studies the law does so for the money, of course, any more than anyone who “invests” in higher education does it strictly on the basis of a financial calculation. A *The Wall Street Journal* article by Anne Marie Chaker sheds light on a new program that may make it less of a financial hardship for those who want to acquire an expensive degree to “do good” more than to “do well.”

The College Cost Reduction and Access Act includes a provision to provide students with incentives to go into fields of public service, by forgiving substantial amounts of the debt people have after leaving school. Not only for lawyers, the law defines public service broadly, to also include careers in public health, in public education, or with not-for-profit organizations. What the law will require is commitment—the balance on loans will be forgiven after ten years of monthly payments while working in public service jobs. With public interest jobs often paying less than a third of what the top private firms pay, this could still seem like a lousy deal. But the newly created Income Based Repayment program would also allow borrowers to have smaller payments during those ten years if they were in careers that had lower incomes. Some wrinkles in the law require a thorough investigation for anyone considering a career decision based on it—forgiven loans are considered
taxable income, for example. But the law definitely offers the possibility of substantially reducing the cost of one’s human capital investment so that it might still make financial sense even if your career choice it not going to be very lucrative.

Finally, and mostly as an aside, there is the question of whether or not one should put ‘M.B.A.’ on a business card. Ronald Alsop answers readers’ questions to The Wall Street Journal’s "Career Journal," and got that one from a reader concerned that he was not perceived as having strong business, financial, or management expertise because he had come from a technical field before getting his M.B.A. Chapter Nine of Modern Labor Economics also discussed the role of signaling and credentialism in the job market. Although there was some mix of responses from those Alsop consulted with, the majority seemed to believe that putting M.B.A. on a business card would probably not help and might hurt your prospects. Said one, “The business skills attained via an M.B.A. should be evident in one’s work or conversations.”

Sources:
"How to Cut Debt, Boost Job Prospects From Law School,” by Amir Efrati, The Wall Street Journal, October 30, 2007 (pp. B1, B7);
"New Incentives May Bolster Public Service,” by Anne Marie Chaker, The Wall Street Journal, October 11, 2007 (pp. D1, D3);

Questions:

1. Is law school general training or specific training? Does that effect how well it will pay off?
2. A loan forgiveness program still doesn’t address the fact that education costs are paid up front. Explain why this reduces the value of the incentive relative to a grant program that paid your school expenses in exchange for a commitment to work in public service after graduation.
3. In what sense might putting “M.B.A.” on your business card be a “bad” signal?