Abstract

This paper introduces and explores signaling in the market for education based on imperfectly observed heterogeneity in the returns to education rather than heterogeneity in costs. Workers of heterogeneous abilities face the same costs of education, yet the productivity gain from education is higher for more able workers, and employers can noisily observe productivity. While a separating equilibrium does not exist, the mixed strategy equilibrium is partially revealing: a larger proportion of high ability individuals self select to attend college. The education premium depends on the equilibrium mix of abilities in and out of college, and is increasing in college costs. Adding a production function of college education, this model can help explain the steady trends in increasing tuition costs, college enrollment, and the college wage gap through its relationship to the quality of college and high school graduates.

JEL codes: J24,121,J31