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OVER-EDUCATION FOR THE RICH VS UNDER-EDUCATION FOR THE POOR: A SEARCH-THEORETIC MICROFOUNDATION

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Over-education for the rich vs under-education for the poor: a search-theoretic microfoundation

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Abstract: This paper provides a search-theoretic microfoundation to the popular view according to which rich but poorly talented individuals crowd out poorer and more talented individuals from schooling. We consider a two-sector, two schooling level matching model of unemployment with ex-post rent-sharing. Individuals differ in ability and schooling cost, the search market is segmented by education, and there is free entry of new firms in each sector. Self-selection in education originates composition effects in the distribution of skills across sectors. This in turn modifies the intensity of job creation, implying the private and social returns to schooling always differ. Agents with large schooling costs – the poor – select themselves too much, while there is too little self-selection among the low schooling cost individuals – the rich. We also show that education should, on average, be more taxed than subsidized.

Keywords: Ability; Schooling costs; Matching frictions; Efficiency

J.E.L. classification: I20, J21, J60