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College: 'Best Investment' or Big Risk?

Hough: The financial return for a four-year degree may surprise you.

By JACK HOUGH

College is the best investment you can make, President Obama told students last month at the University of Colorado.

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As a metaphor for the benefits of education, that statement is fine. But taken as a claim about the financial returns of a college degree, it poses two problems.

The first is that students and their families still lack sufficient data to estimate long-term returns for specific college degrees the way investors do with stocks and bonds.

The second problem is one of investment risk. Stock investors can manage risk by buying a diverse basket of shares, but a college student bets on a single asset: himself.

That makes it crucial that students and their families understand the factors that affect the risk and return of a college investment in order to swing the math in their favor.

College brings higher pay: $1,053 a week for the median bachelor's degree holder last year, versus $638 for a high school graduate with no college, says the U.S. Bureau of Labor Statistics. Last year's unemployment rate was 4.9% for college grads versus 9.4% for those with no college.

The College Board, a not-for-profit association, calculated in a 2010 report (based on 2008 data) that a typical student who enters a four-year college at age 18 and borrows his way through earns enough by age 33 to make up for his costs, including foregone wages and loan interest.

If a bond paid for itself that quickly, the return would be between 5% and 6% a year. That's a handsome payoff; stocks have historically returned around 7% a year after inflation. And it says nothing of college's other benefits, such as enlightenment, fun and higher job satisfaction.

Two big caveats: The College Board math assumes everyone goes to a public college. Those usually cost less than private ones -- often a lot less -- and that skews returns higher. The report also doesn't account for dropouts or extra college years. Only 56% of students who enroll in a four-year college earn a bachelor's degree within six years, according to a report last year by the Harvard Graduate School of Education.

PayScale, a Seattle data firm, examines the links between pay and variables like colleges and majors. Its analysis, which also ignores dropouts but accounts for students who take longer to complete their degrees, finds an average yearly return of 4.4% for degrees from 853 schools. That assumes students get financial aid, as most do.

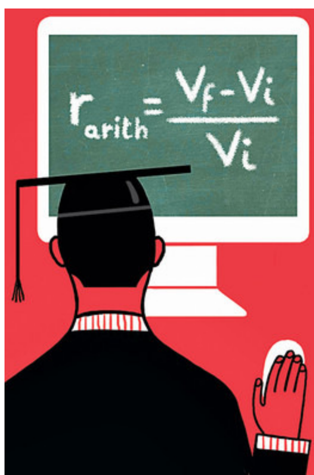

Illustration by Luci Gutierrez

Returns vary sharply; they are negative for more than 100 schools and over 11% a year for ones like Harvey Mudd College in California, the Georgia Institute of Technology and the University of Virginia. Dartmouth, Harvard, Stanford and Princeton are over 10%, but so is Queens College in New York -- where state residents pay just over $5,000 a year in tuition, versus about $41,000 for Stanford.

The worst returns tend to come from schools whose programs focus on nursing, criminal justice, sociology and education, says Katie Bardaro, an analyst at PayScale. The best returns are often from schools with strong engineering, computer science, economics and natural-science programs.

There's a flip side: "It's a lot harder to successfully graduate from those engineering programs," says Ms. Bardaro.

PayScale's analysis doesn't show how a specific degree from one school compares with that same degree from another school. "Until we know that, students, school counselors and policy makers are flying blind," says Mark Schneider, former U.S. Commissioner of Education Statistics and vice president of American Institutes for Research, a think tank.

Mr. Schneider set up a data firm, College Measures, to collect such data, and hopes to report his findings later this year. In the meantime, the U.S. Department of Education is set to release "gainful employment" data as soon as this coming week, including loan-repayment rates and debt-to-income ratios. The information is meant to show which schools are putting federal aid to good use, but it will also provide clues to returns.

Until we can predict college returns more accurately, students and their families should think in terms of reducing investment risk, says Richard Vedder, an Ohio University professor and director of the Center for College Affordability and Productivity, a Washington-based advocacy group. After all, outstanding student loans now eclipse total credit-card debt, and even bankruptcy filers don't typically get out from under their school loans.

Start with a frank assessment of performance. High school students with high grades and excellent test scores are likely to go to good schools and earn high returns on their investment, says Mr. Vedder. Middling performers can reduce risk by going to low-cost state and community colleges, perhaps transferring to another school after two years if they do well.

For that matter, anything that cuts college costs reduces investment risk, says Jennifer Ma, a College Board analyst. Living at home for the first two years of school won't do wonders for a student's social life, but it's likely to boost his returns.

Mr. Schneider says students should compare net college costs after projected aid. (They can approximate net costs using the government's College Navigator tool, nces.ed.gov/collegenavigator.) The riskiest investment is a high-cost liberal-arts college that lacks a strong brand name and doesn't offer much aid, says Mr. Schneider. By contrast, a high-cost school with a strong brand and plenty of aid may be a "good buy."

PayScale's Ms. Bardaro says students should research carefully the pay they are likely to secure before deciding how much to spend on college. After all, tuition and fees have increased 184% in 20 years after accounting for inflation, but wages for college grads have risen just 9%, according to Labor Department data.

Mr. Obama's investment tip is well-intentioned, but in college as on Wall Street, returns aren't guaranteed.

—Jack Hough is a columnist at SmartMoney.com. Email: jack.hough@dowjones.com

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