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The Role of Education and Income

**Introduction:**

Education is a major key in everyone’s life and for the most part is a major deciding factor for the amount someone is going to get paid. Those who do not attend college earn significantly less than people who do and since productivity is linked to education the farther you go in school, the higher productivity you will have. This is important for our economy because when employers can produce more while using the same resources it creates more profit and more money an employer has available to increase wages. Therefore, an education is important for everyone to invest in.

**1. How does high productivity result in higher wages for workers?**

Higher productivity results in higher wages for workers because the more efficient a worker is in a company the more willingly the company can pay the specific worker/workers. The article *College: Learning the Skills to Pay the Bills?* By Scott A. Wolla, expresses this fact to be true. He states, “Workers with more education tend to have higher productivity, which means they tend to produce more output with the same inputs. Because businesses can sell this extra output to earn higher revenues, firms are willing to pay highly productive employees a higher wage” (Wolla, 2015). This quote brings up an important understanding to why higher productivity is important to an employer because if they can create more product while using the same amount of resources, then that just increases profit for the employer. In result of this, an employer can now pay more to its employees due to the more available funds. This is an important factor that plays a big roll into the economic wage gap between college graduates compared to high school graduates due to the fact that college graduates have higher productivity, higher wages, and more skills to bring into the job environment than normal high school graduates do.

**2. If you blend the two models (the human capital model and signaling model), how might you describe the benefits of education?**

Two models that can express another reason to go achieve a higher education is the human capital model and the signaling model. Both models express advantages and reasons why people should pursue a higher education. To go in depth, the human capital model is the investment a worker puts in their future such as a higher education, training, or work experience. This model is important because it expresses the opportunity cost going to college rather than earning income instead. Wolla states, “College students give up the opportunity to work (and earn income), but the knowledge and skills acquired will enable them to earn more in the future. This is generally a good trade-off” (Wolla, 2015). In simple terms this quote is saying that it would be a better investment to go to college than go straight to work due to the vastly higher income you earn with a degree. The signaling model expresses “That education primarily serves as a signal of one's productivity. And, not surprisingly, the economic model that captures this is known as the signaling model” (Wolla, 2015). This model is a way for employers to determine whether a potential employee is high-productive or low-productive, since during the interview process most potential employees will say they are highly productive. These two models clearly show that getting a higher education is worth the investment because you earn more income after college than you do after high school due to the signaling model which shows an employer that you are highly productive. Thus, the more productive you are the more income you will receive.

**3. Explain why the relationship between education and income might not be as simple as it first appears.**

Even though there is a correlation between education and income, correlation does not mean that there is an interconnection. As stated, the more education you have the higher productivity you have therefore the higher the income, but there is no guaranteed relationship between education and income. The article *Education, Income, and Wealth* by Jessica Sullivan states, “Likewise, while at least some of the college wage premium is due to the knowledge and skills acquired through education, other factors, such as the following are surely at play” (Sullivan, 2017). As she expresses, the other factors coming into play are natural ability, assertive mating, inheritance, and health. These factors make it difficult to understand the relationship between income and education because for example, someone with natural ability can graduate college with ease and have more success in the job market than someone who does not have that ability. Same goes with inheritance and marriage, both expand the college wage premium because people with an inheritance have more income from the start. Additionally, college graduates who marry each other will have double the income. Lastly, health is a key role because people with more education tend to be healthier which promotes long lifespans and longer life-time earnings. That is why there is some discrepancy when it comes to the relationship between income and education, those four factors play a major role into that association.

**4. What is necessary to turn income into wealth? Also, describe how the financial habits, such as liquidity, diversification, low debt relative to assets, contribute to well-educated families’ ability to build wealth over time.**

Turning income into wealth can seem as daunting, especially when expenses and debt come are inevitable in everyone’s life. Practicing good financial habits is critical in this process and is a determinant on whether someone will ever be wealthy or not. So, the simplest way to try to build wealth is to save. For as easy as it sounds it is effective, if we investigate German households it shows “A relatively high savings rate (on average 16.7%, one of the highest among OECD countries)” (Beisemann, 2016). This is relevant because German Households are on their way to becoming wealthy through an increased savings and we can see this through their education habits. According to the OECD, 86% of the country’s 25-64-year old’s have attained a college education. For anyone wanting to build wealth, a savings account is important because it can potentially be a liquid asset. Having liquid assets makes your income more flexible during a financial crisis because it allows you to not sell your primary assets or take on any debt. Another habit to build wealth is to diversify, “To diversify means to invest in various financial instruments to reduce risk” (Sullivan, 2017). Diversification is another good financial habit because through investment in business, stocks, and bonds one can achieve high returns from their investment with a calculated reduction of risk. Lastly to turn income into wealth you want to keep your debt low relative to your assets, this is essential because people with a high debt-to-asset ratio tend to payer higher interest rates therefore making it difficult to save. In an investors point of view, according to Will Kenton in the article *Total-Debt-to-Total-Assets Ratio Definition*, he states, “Investors use the ratio not only to evaluate whether the company has enough funds to meet its current debt obligations but also to assess whether the company can pay a return on their investment” (Kenton, 2019). Being able to analyze companies for potential investments contributes to wealth just as much as anything else, you would not want to jeopardize an investment due to not analyzing a company’s debt to asset ratio. These financial habits are common with well-educated families, as we can see with Germany, because it builds wealth over time.

**Conclusion:**

In conclusion, higher productivity results in higher wages because it allows a company to create more profit while using the same amount of resources. For someone to be deemed as highly productive in the signaling model, they must invest in their human capital such as getting a higher education. Even though there might be a causation between higher income and higher education, factors such as natural ability, inheritance, marriage, and health prevent the interconnection. Well educated families look to build wealth over time by practicing good financial habits, they look to have their money work for them by making diverse investments and keep a nurtured savings account.

**Reference:**

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