

**AN EMPIRICAL TEST OF THE RISK-RETURN TRADE-OFF IN EDUCATIONAL CHOICE**

Xueyu Cheng, Alabama State University, Montgomery, Alabama, USA

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**ABSTRACT**

Education is commonly viewed as an investment in human capital. Is there a risk-return trade-off in education as in financial assets? This paper empirically tests the correlation between the risk and return of education using the Current Population Survey (CPS) data in 1968-2006. I construct longitudinal data by matching the consecutive CPS March supplements. I assume that the return to education is heterogeneous across individuals and random. I estimate a mixed model of earnings with random coefficient on schooling. Part of the estimation of the mixed model includes estimation of the variance-covariance structure of the random coefficients. I use the estimated variance of the random return to education to measure risk in educational choice. I find that the risk and return of education is positively correlated and the risk of educational investment has a significantly positive effect on the return to education.

Keywords: *Education, Human Capital Investment, Risk-Return Trade-Off, Mixed Model*