

ABSTRACT

This paper uses the framework of an OLG economy for an analysis of the dynamic interaction between the precision of information about individual skills, investment in education, human capital accumulation and social welfare. The human capital of an individual depends on both his (subjectively) random ability and his investment in education. Individual investment in education is financed through a loan contract with income-contingent terms of repayment. Investment decisions are based on public signals (test outcomes) which screen all agents for their abilities. We find that better information, which allows more efficient screening, enhances aggregate human capital formation but may, at the same time, stifle aggregate investment in education. Moreover, social welfare may increase or decline depending on the transformation technology and on the relative measure of risk aversion.

Keyword and Phrases: Information system, higher education, human capital, welfare.

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