

LIVING AN ECONOMICAL LIFE

Daniel McFadden, Economics Department Commencement Address, University of California, Berkeley, 2012

Economics Graduates, Parents, and Friends. I am very pleased to be able to address you today, and to offer my congratulations to the graduates. You have successfully completed one of the most challenging degree programs in the world of economics, and are superb examples of what talented students can accomplish in a great university.

I hope that the rigors and challenges of Berkeley have prepared you for what lies ahead. Today, the market for college graduates is difficult, the American economy is fragile, Europe is in recession, the Euro is collapsing, the Chinese economy is faltering, Washington and Sacramento are in deadlock, and our financial institutions continue to take giddy risks. You will experience first-hand the vicissitudes of market life. I have confidence that you will overcome these obstacles. You are trained to live in interesting times, and take pleasure in unraveling the puzzles that the economy presents. Don't wait passively for opportunities to come along. Make your own breaks. Seek technological superiority in your eventual field of endeavor, whether academic economics, management, or law; your education has opened the door. Look for experiences outside commerce and outside the U.S. Keep your mind open and continue to learn. The Great Recession will come to an end – there are no major structural impediments to a rebound, and you can ride the wave of recovery. Your ingenuity will be tested, but you will thrive.

I will talk today about social mobility in America, and the costs of higher education. The University of California is an institution that grew out of a social commitment to provide affordable higher education to all students of merit, no matter what their economic background. In common with other public universities, it has been an important vehicle for social mobility in America. Many of you are from families that are fairly recent immigrants to the United States. Historically the combination of open doors for immigrants, wide access to higher education, and high social mobility made it possible for talented people to come to America, and in a generation or two achieve distinction. This path was never easy, even when the borders were almost entirely open. An Italian immigrant in the first decade of the last century said: "When I came to America, I learned three things: One, the streets were not paved with gold. Two, the streets were not paved. Three, I was expected to pave them." But in spite of these hurdles, people could start poor and fight their way up. I am a prime example. My parents lost their jobs in the Great Depression, and I grew up on a subsistence farm, dirt poor but surrounded by books. At age 16, after getting suspended from high school for circulating a civil rights petition, I entered the University of Minnesota by examination. I financed my first year of college by selling a cow to pay my tuition, and working two jobs to cover the rest. A year later, I had a steady job in a research lab, and was hooked on the academic life. If the price of college had been more than one cow, I would instead have had to go to work without a high school diploma, and who knows what my path would have been.

I am grateful to public education for giving me a chance, and to our economic system for allowing me to build a comfortable life. Three decades ago, I was teaching at MIT, and was named the James Killian Professor of economics. Dr. Killian was a beloved ex-president of MIT, and had served as President Eisenhower's science advisor. I met the gentleman after being appointed to this chair, and we found out after some discussion that my grandfather had been chief mechanic in a cotton mill owned by his grandfather. When I related this

coincidence to my MIT colleague at the time, Robert Solow, he put it in perspective, “So much for social mobility in America, after three generations, you are still a mechanic in Killian’s mill.” Be that as it may, my story shows what was achievable in an era of inexpensive public higher education. My takeaway from all this is that we should treasure and support public universities, and extend a helping hand to the next generation as they strive for success.

In the past decade, there has been a disturbing change in America. Public higher education as a path for social mobility has become less accessible and less affordable. Thomas Friedman said in the New York Times this morning, “The costs of getting a college degree have been rising faster than those of health care, so the need to provide low-cost, quality higher education is more acute than ever.” Recent economic studies have found that in Great Britain, a country long noted for its rigid class structure, it is now easier to move from the bottom 10 percent to the top 1 percent than it is in the United States.

During your time at Berkeley, you have been battered by these rising college costs. Many of you have taken student loans to cover some of these costs, and now face mountains of debt. At the same time, Berkeley and other public universities are under increasing financial stress as the government’s share of their budgets decline. Draconian new cuts in the California state budget were announced a few days ago that threaten the foundations of this university. The recession-strained public is wavering in its commitment to accessible, affordable public education. Berkeley is still a bargain relative to private universities, but the gap is narrowing. To survive, Berkeley may have to imitate private universities, and their tuition charges. It is enough to make one see red. What can and should be done about it?

As economists we can ask ourselves why high college costs are a problem. A Chicago-style market economist has this to say about the situation: “Public universities should charge what the market will bear, just like the private ones do. People with college degrees earn higher incomes, so a college education is an investment that produces a stream of returns. Students can do the economic calculation. If they judge the investment to be worthwhile, they can make it, using debt financing if necessary. Competition between universities will make education cost-effective. If poor students require subsidies, finance them by increasing tuition to those who can afford it. The arrangements between students and universities are contracts between willing parties. Leave the market to work its magic.”

What is wrong with this story? The answer is that there are huge social externalities to providing students with higher education, and with promoting access on merit alone, unconstrained by ability to pay. Not only does society gain from an educated population, the added contributions college graduates make through entrepreneurship, invention, and discovery are not all captured as private returns on their personal investment. They accrue to society as a whole. Society benefits from your education, and it should willingly pay a share of the investment to obtain its share of the returns.

What should America do, and what can you do, about high college costs and impediments to social mobility? Today, I call for Berkeley undergraduate tuition to roll back to the price of one cow. America is a rich country. Surely it can do at least as well for the students of today as it did for me in 1954. Of course, we know as economists that if the quality of education is to be maintained, lost tuition fees have to be replaced from other sources. What are Berkeley’s options? First, while research is vital to what this university is, and to the quality

of its faculty, research activities should pay their own way. California businesses who are the primary beneficiaries of university research and development should support the research program, if necessary through taxes. On the university side, technology should be exploited to make undergraduate education more efficient and affordable. Work/study should become a way of life. Berkeley and its faculty should lead the development of new interfaces with students, on the internet and otherwise, that communicate more effectively, make learning more fun, reduce cost, and increase access.

What you can do in this cause is first to vote, educate, and persuade the people of California that affordable accessible universities are an economic engine for the state, and a generator of future jobs and economic growth. Most importantly, you can set an example, through your own perseverance and success, of the social value of bright, well-educated young men and women from all walks of life. Work hard! Break through the glass ceiling! Smash the Stanford ceiling! Take on the one percent, and eat their lunch!

Since I have forecast a challenging economic future for you, I feel it is my duty in closing to summarize your economics education at Berkeley in ten rules for an economical life. Some of these will be very familiar, some others may be new:

1. There's no such thing as a free lunch.
2. Follow the money. Leave no economic motive unexamined.
3. What's sunk is sunk. Learn from the past, but act for the future.
4. Moral fiber is weakest when cut by self-interest.
5. There are plenty of selfish reasons to be altruistic.
6. Bargain hard, but then give something back at the end. You will be remembered for your fairness on the next bargaining occasion.
7. Pick your spot on the hedonic treadmill. Expect the worst, and take pleasure in being surprised.
8. There is an element of trust in every economic transaction. A reputation for honesty and fairness is money in the bank.
9. Any parrot can be labeled an economist; it only needs to know two words, "demand" and "supply". To distinguish yourselves from parrots, and from most of the general population and most bankers, learn the meaning of the terms "credit default swap" and "due diligence".
10. If someone claims that economists know the price of everything and the value of nothing, be modest. We don't know the price of everything.

With these rules, you are armed to take on the world. The best of luck with your futures. Don't forget us, and come back to visit. Stand up for Berkeley and public education. Go Bears!