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Human capital measures and stock return predictability: Macroeconomic versus microeconomic approaches

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Abstract

This letter measures human capital returns in a microeconomic sense as returns to education using Korean survey data, and compares them to the traditional macroeconomic measures, such as labor income growth. Both measures exhibit similar patterns of correlation with important economic variables and financial returns. However, returns to education are distinguished from labor income growth by a notable positive correlation with stock cash flow innovation and the consumption–wealth ratio (*cay*). Further, in a predictive regression of financial asset returns, labor income growth presents a negative expectation for future excess stock returns, whereas returns to education exert a positive influence similar to *cay*. These results show that returns to education reflect another aspect of human capital returns that labor income growth does not reveal.

Keywords: Human capital returns; Labor income growth; Return predictability; Returns to education

JEL Classification: G12; I22; I26; J24

1. Introduction

Most theoretical models consider human capital as an asset essential for economic decisions made by individuals and for the aggregate economy. As a non-tradable asset, however, its returns can only be approximated by a proxy and not measured directly. Previous literature indirectly measured human capital returns by assuming they are linearly determined by growth in labor income (Campbell, 1996; Jagannathan and Wang, 1996; Lustig and Van Nieuwerburgh, 2008; Eiling, 2013). Importantly, some studies including Santos and Veronesi (2006), Julliard (2007), and Eiling (2013) emphasize the role of labor income growth or its risk for asset pricing. On the other hand, studies that take a microeconomic view propose to measure human capital returns directly through survey data that report investment in education. Those studies generally apply Mincerian wage equations to estimate returns to education, disclose estimates of groups affected differently by sociopolitical conditions, and identify critical influences on investment in education (Chiswick, 1988; Duraisamy, 2002; Psacharopoulos and Patrinos, 2004). Focusing primarily on estimation error, Card (2001) explores why returns to education generally exceed returns to tradable assets. However, only a few studies analyze the differences between growth in labor income and returns to education—a macroeconomic versus a microeconomic approach. To fill this gap in the literature, this study investigates patterns of time-series correlation between them and other economic variables. Further, it examines the predictability of

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