Commentary: Human Capital and Economic Growth

James C. Miller III

Most of us in this room—I dare say most adult Americans—were challenged as children to "make something of ourselves," specifically to "get an education." The fervor of the plea in my own case may have been a bit unusual—you see, unlike Senator Joe Biden, I am the first in my immediate family to get a college education. But I doubt very many haven't heard somewhere along the way the clarion call for educational attainment.

Such calls, I believe, reflect more than the private returns from an education, as in "I want my children to get good jobs," or even pride, as in "Let me tell you about my daughter who's just graduated from Reed and plans to go to medical school." It reflects, I think, a general recognition that education creates some social values—as we economists would say, some positive externalities. Whether this hypothesis is true, I cannot say. After all, if people are paid their marginal products and there are constant returns to scale, private returns to education exhaust the contribution to output, and hence there is no social "surplus." Moreover, education leads to higher incomes and therefore envy—a cost that's highly relevant as is obvious from recent political demagoguery.

Professor Barro, in this and previous papers, concludes that education—more specifically the stock known as human capital--contributes to economic growth, ceteris paribus.[1] Thus, distribution aside, education in the aggregate generates benefits—almost surely ***net*** benefits—to society. One implication of Professor Barro's impressive

and extensive work is that it would be highly desirable to design and implement public policies to promote education.

I shall get to that. But first, I want to make a few observations about the issue of economic growth.

The first observation is that I am glad to see relatively little public anxiety over the fact that some of our international commercial competitors, not to mention our (former) international security competitors, have higher growth rates than we have—in the aggregate or on a per capita basis. Remember the clamor over the Soviet growth rate in the late 1950s and early 1960s? As Warren Nutter pointed out at the time, a less developed country can forever grow at a rate exceeding the growth rate of a developed one and never overtake the latter. As Nutter explained with an analogy, each year a child grows in age a greater portion of his or her age than does the parent, yet the child will never be as old as the parent.

Second observation: the rate of economic growth is mightily important, not only in terms of real incomes but in terms of the stability of the social fabric. Professor Barro points out that the rate of economic growth and simple measures of political stability are inversely related. His hypothesis is that, with instability, property rights are at jeopardy and thus people have less incentive to invest. But he also offers the reverse causation as a possible explanation for the correlation—that an economy with a low growth rate is prone to political instability.

In a ***much*** less attenuated form, we see evidence of this latter hypothesis here in this country, in this political season. Does anyone here really doubt that if the economy had been growing at 4 percent annually the past three years President Bush would be a shoo-in and that far fewer members of Congress would be in jeopardy? On a more general scale, it has been my observation that social unrest, ranging from general dissatisfaction to riots, is more common when the economic growth rate is low than when it is high. Also, I merely mention that a recent issue of a publication by the Federal Reserve Bank of Dallas, now headed by my good friend and conference participant, Bob McTeer, notes that: "Major oil companies' interest in foreign prospects is becoming stronger because of increasing political

risk at home and decreasing political risk abroad."[2]

Third, small differences in the rate of economic growth make for big differences in future income levels. For example, if we were able to raise the annual growth rate in per capita income from 2 percent to 4 percent, the first generation would be about half-again better off, and the second generation would be about twice as well off.

So, economic growth is important. How do we raise the rate of growth? Let me address two specifics before getting to education. I was intrigued with Professor Barro's result that, ceteris paribus, government consumption (not counting defense and education) as a proportion of total output *reduces* the rate of growth (also, that government investment has no significantly-different-from-zero effect on growth). I would suggest that he look into the possible effects of government-impelled *redistribution* on growth. Although redistribution, as well as consumption, is related to government tax policies, it is possible to conceive of their effects differently—taxes being a net reduction from the rewards of increased effort, and redistribution being a reward for reduced effort.

To my knowledge—and admittedly it is limited—no one has quantified the extent to which, if any, that redistribution adversely affects the rate of economic growth. Yet the issue is of some importance. In an unpublished paper, Gordon Tullock shows that even small negative effects of redistribution on the rate of economic growth can lead to present-day recipients of redistribution being worse off after a few generations.[3] That is, even though redistribution may make recipients wealthier now, the institution of redistribution can so slow growth that the time comes that even with redistribution they are worse off (that is, have lower incomes) than if there had been no redistribution. And, given reasonable rates of discount, it is even possible that present-day recipients of redistribution are *worse off* than they would be in the absence of redistribution, or a lesser degree of redistribution, or maybe a better designed system of redistribution. Again, this is an empirical issue, but it is one that I think deserves careful study.

On a related issue, *spending* is just one way in which governments obtain control over resources. (Spending, of course, is financed with

taxes and debt.) The other major control is conscription, the major form of which falls under the rubric, regulation. In terms of relative magnitudes, recently Professor Tom Hopkins of Rochester Institute of Technology estimated that the gross costs of thefederal portion of regulation amounts to approximately $400 billion annually.[4] That's an amount equal to about one-quarter of federal spending. What I'm suggesting—and I realize how hard it is to come by good numbers in this area—is that consideration be given to exploring the effect, if any, of this aspect of government on the rate of economic growth.

My final observation is that we can, of course, go overboard with respect to formulating and implementing policies to increase the rate of economic growth. One could easily imagine draconian measures by government to increase savings and investment, and hence growth, far beyond that which would obtain in a more neutral policy framework. I, personally, would not favor so limiting individual freedom in pursuit of a narrow growth objective. Sometimes governments get carried away with worthy goals and push them to excess. In the commercial areas, the premature development of a U.S. supersonic transport comes to mind, as well as the launching of a publicly funded space station.

Let me turn now to public policies to improve education—and thereby increase the rate of economic growth. The element on which I wish to focus is how to increase the quality of lower education in this country—that is, kindergarten through 12th grade. And, I start with the assumption that, by and large, lower education will continue to be publicly financed.

The first point I wish to make is that though there has been a well-publicized decline in standard test scores and deterioration in the rankings of U.S. student performance relative to students in other developed countries; the problem would not appear to be money. First, as is well known, spending per pupil in the United States has risen steadily while student performance has fallen.[5] Second, for 15 developed countries other than the United States for which we have comparable data, the average expenditure per pupil was $2,370 in 1985, whereas the U.S. expenditure per pupil was $3,314—nearly $1,000 more.[6] The only country with a higher per-pupil expenditure

was Switzerland, which spent a lower portion of its GNP on lower education but had a significantly lower portion of its population enrolled.' Third, cross-section analyses of student performance typically show little effect of spending on quality. For example, recently I had some regressions run using data from the 100-plus school districts in Virginia. Variations in per-pupil spending were positively correlated with student performance, but spending explained only 6 percent of the variation.[8]

What's the problem? I ask rhetorically, why is it that U.S. higher education is the envy of the world, whereas **U.S.** lower education is an international laughing stock? There are many reasons, but two in particular stand out: one, there is much more ***competition*** for students among institutions in higher education than in lower education, and two, to a greater degree higher education in the **U.S.** is ***privately*** (or quasi-privately) produced, whereas lower education is dominated by public production.

For an audience of persons with economics expertise, I need not waste time persuading you of the superiority of competition over monopoly and the superiority of private over public production where both are feasible. Yet, production of what Professor Barro identifies as a key determinant of economic growth—human capital—is terribly encumbered by an extraordinarily inefficient system that appears incapable of reform. The notion of ***choice*** in education--even vouchers—is popular, but change is very slow. I have very little confidence that the federal government will make much progress on this score, even though both presidential candidates support ***some*** measure of school choice (Governor Clinton ***only*** for choice among ***public*** schools, President Bush for choice among public ***and*** private schools). However, I am hopeful that various local experiments with school choice—in New York, in Wisconsin, in Minnesota, and in other states—will be so successful that they will win a growing bandwagon of converts and will lead to long-overdue reform of U.S. education. An increase in the rate of economic growth would be but one of the major benefits.

Endnotes

[1]See, for example, Robert J. Barro, "Economic Growth in a Cross-Section of Countries," ***Quarterly Journal of Economics*** (May 1991), pp. 407-43 and other papers cited therein.

[2]***The Southwest Economy*** (July/August 1992), p. 6.

[3]Gordon Tullock, "Thoughts on Redistribution," unpublished (1992).

[4]Thomas D. Hopkins, ***Cost of Regulation,*** Rochester Institute of Technology Working Paper (December 1991).

[5]U.S. Department of Education, ***Digest of Education Statistics, 1991,*** pp. ***123*** and 157.

[6]***Statistical Abstract of the United Smtes, 1991,*** p. 840.

[7]***Ibid.*** Switzerland had the lowest enrollment—14.2 percent (vs. 19.7 percent for the United States). Its expenditure per pupil was $3,683.

[8]As reported in Dana C. Joel, ***Education Choice: Closing the Gap in Student Performance*** Washington: Citizens for a Sound Economy, 1991, p. 9.