THE MYSTERY OF ‘HUMAN CAPITAL’ AS AN ENGINE OF GROWTH
or, why the US has become the economic superpower in the 20th century

by

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ABSTRACT

Common in much of the “new” economic growth and development literature is the idea that persistent, self-sustaining growth in real per-capita income is attributable to “human capital”. The concept is wrapped up in three layers of mystery: a. Since it is not a tangible asset, how do we account for human capital empirically? b. What dictates its formation over time? c. How is such formation transformed into growth in real production?

One of the objectives of this presentation is to unwrap this apparent mystery through an exposition of a general-equilibrium model of economic development where human capital is the critical engine of growth, its accumulation is enhanced by parental and public investments in children’s education, and underlying “exogenous” institutional and policy variables are ultimately responsible for **both** human capital formation and long-term growth. The model is developed in the context of a competitive market economy in which human capital, measured **imperfectly** by indicators of schooling and training, is competitively rewarded and efficiently allocated to productive activities. The model also recognizes, however, the role of externalities affecting the accessibility and financing costs of schooling, the efficiency of the economy’s labor and product markets, and the spillover effects emanating from workers possessing higher education and skill on the productivity of other workers. The way these externalities are “internalized” may vary, however, as a function of the institutional and legal framework governing the market economy, and as a consequence of accommodating economic and educational public policies, especially in so far as higher education is concerned. Such variations may ultimately explain differential growth patterns across different countries.

A more specific objective of the presentation is to illustrate the power of the “human capital hypothesis” to explain observed differences in long-term growth dynamics across different countries. The case in point is the emergence of the US as the world economic superpower. While Europe was the world’s economic leader in the late 18th and most of the 19th century, during the 20th century the US developed considerable advantage over Europe in the schooling attainments of its labor force, at all levels of education. The gap remained significant through the entire century, although it narrowed considerably in the decades following WWII. Largely accounting for this gap was the massive high school movement of 1915-1940, but an independent gap emerged as early as the 1860s with the US foray into tertiary education beginning with the first Morrill act of 1862, and continued with the massive higher education movement post WWII. The basic thesis of this paper is that the US lead in educational attainments, especially at the tertiary level, since the late 19th century, constitutes a major, and perhaps **the** major factor that accounts for its overtaking Europe as the economic superpower in the 20th century.