

Education for growth in Sweden and the world

Alan B. Krueger* and Mikael Lindahl**

Summary

■ This paper tries to reconcile evidence on the effect of schooling on income and GDP growth from the microeconomic and empirical macro growth literatures. Much microeconomic evidence suggests that education is an important causal determinant of income for people in countries as diverse as Sweden and the US. But at a national level, recent studies have found that increases in educational attainment are unrelated to economic growth. This finding is shown to be a spurious result of the extremely high rate of measurement error in first-differenced cross-country education data. After accounting for measurement error, the effect of changes in educational attainment on income growth in cross-country data is at least as great as microeconomic estimates of the rate of return to years of schooling. We also investigate another finding of the macro growth literature: economic growth depends positively on the initial human-capital stock. We find that the effect of the initial level of education on growth is sensitive to the econometric assumptions that are imposed on the data (e.g., constant-coefficient assumption) and to the other covariates in the model. Perhaps most importantly, we find that the initial level of education does not appear to have a significant effect on economic growth among OECD countries. Based on the human-capital literature, the conclusion comments on policy implications for Sweden. ■

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[W]hat was rather jarring is the repeated finding, in these international data that changes in the estimated levels of schooling or human capital do not contribute positively to growth, at least measured over the 1965-85 period.

—Zvi Griliches, 1997

Research on the economic effects of education was marked by two contradictory sets of findings in the 1990s:

1. The micro labour literature produced several new estimates of the monetary return to schooling that exploit natural experiments in which variability in workers' schooling attainment was generated by some exogenous and arguably random force, such as quirks in compulsory schooling laws or students' proximity to a college. These studies tended to find that education is an important determinant of income.
2. The macro growth literature has found that changes in average levels of schooling across countries are unrelated to economic-growth, although the initial level of schooling is related to the countries' subsequent GDP growth rate.

This paper tries to reconcile these two disparate but obviously related lines of research. Section 1 reviews the theoretical and empirical foundations of the Mincerian human-capital earnings function. Our survey of the literature indicates that Mincer's (1974) formulation of

* We thank Robert Barro, Anders Björklund, Angus Deaton, Richard Freeman, Zvi Griliches, Gene Grossman, John Hassler, Bertil Holmlund, Larry Katz, Kjetil Storesletten, and seminar participants at the London School of Economics for helpful discussions, and Peter Skogman, Mark Spiegel and Bob Topel for providing data. Alan Krueger thanks the Princeton University Industrial Relations Section for financial support; Mikael Lindahl thanks the Swedish Council for Research in the Humanities and Social Science for financial support. This paper draws heavily on Krueger and Lindahl (1998), which provides a more technical presentation of many of the results.

the log-linear earnings-education relationship fits the data rather well. Each additional year of schooling appears to raise earnings by 5-15%, depending on the country, with the US on the high end and Sweden on the low end of the distribution. The rate of return to education varies over time and across countries. Perhaps surprisingly, there is little evidence that unobserved variables (e.g., inherent ability), which might be correlated with earnings and education, cause simple OLS estimates of wage equations to significantly overstate the return to education in most countries. Consistent with Griliches's (1977) conclusion, much of the modern literature finds that the upward *ability bias* is of about the same order of magnitude as the downward bias caused by measurement error in educational attainment. Section 1 also discusses evidence on possible differences in the payoff to investments in human capital across subgroups of the work force.

Section 2 considers the empirical macro growth literature. First, we relate the Mincerian wage equation to the macro growth model. The Mincer model implies that the change in a country's average level of schooling should be the key income-growth determinant. By contrast, the macro growth literature typically specifies growth as a function of the initial level of education, not the change in education. Moreover, we show that if the return to education changes over time (e.g., because of exogenous skill-biased technological change), the macro growth models are unidentified. Much of the empirical growth literature has eschewed the Mincer model because studies such as Benhabib and Spiegel (1994) find that the change in education is not a determinant of economic growth. But we show that Benhabib and Spiegel's finding that the growth in education is unrelated to economic growth results because there is virtually no signal in their education data conditional on capital growth.

The macro growth literature has devoted only passing attention to problems caused by measurement errors (i.e., mistakes) in estimated average education. Despite their aggregate nature, available data on average levels of schooling across countries are poorly measured, in large part because they must often be derived from school enrolment

flows. The reliability of country-level education data is no higher than the reliability of individual-level education data. For example, the correlation between Barro and Lee's (1993) and Kyriacou's (1991) measure of average education across 68 countries in 1985 is 0.86, and the correlation between the change in schooling between 1965 and 1985 from these two sources is only 0.34. Additional estimates of country-level education data reliability, based on our analysis of comparable micro data from the *World Values Survey* for 34 countries, suggests that measurement error is particularly prevalent for years of secondary and higher schooling. We find that measurement errors in education severely attenuate estimates of the effect of the change in schooling on GDP growth. Nonetheless, we conclude that measurement errors in schooling are unlikely to cause a spurious positive association between the initial level of schooling and GDP growth across countries, conditional on the change in education. So like Topel (1998), we conclude that the change and the initial level of education are positively correlated with economic growth.

Finally, we explore the robustness of the impact of the initial level of schooling on economic growth. First, we estimate a variable-coefficient model that allows the coefficient on the stock of education to vary across countries, as is found in the micro data. Second, we relax the linearity assumption of the initial level of education, and explore the effect of controlling for additional explanatory variables. Third, we estimate growth equations for the subset of OECD countries. These extensions show that the positive effect of the initial level of education on economic growth is sensitive to econometric restrictions that are often rejected by the data.

Our main conclusion is that while support for the micro Mincerian wage equation is strong, the evidence of a positive effect of the education stock on a country's growth rate is less robust. Moreover, if one accepts the assumptions necessary to interpret the coefficient on the initial level of education in cross-country growth regressions as identifying externalities from education, the results most likely do not apply to OECD countries.

1. Microeconomics of the private return to education

The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom and education.

—Adam Smith, 1776

Adam Smith suspected that education and other environmental factors were more important economic-success determinants than people's natural ability. Since at least the century's beginning, economists and other social scientists have tried to estimate the economic rewards that people receive from completing more schooling.¹ It has long been recognised that workers who attended school longer may possess inherent abilities that would lead them to earn higher wages irrespective of their levels of education. If these other characteristics are not accounted for, then simple comparisons of earnings across individuals with different levels of schooling would overstate the rate of return to education. Early attempts to control for this ability bias included the analysis of data on siblings and twins to difference-out unobserved family characteristics (e.g., Gorseline, 1932; and Taubman, 1976), and regression analyses, which included as control variables observed characteristics such as IQ and parental education (e.g., Griliches and Mason, 1972). By now, this literature has been amply surveyed in Griliches (1977), Rosen (1977), Willis (1986), and Card (1998). The next section briefly reviews evidence on the Mincerian earnings equation; it emphasises recent studies that use exogenous variation in education to estimate the Mincerian earnings equation.

1.1. The Mincerian wage equation

Mincer (1974) showed that if the only cost of attending school an additional year is the opportunity cost of students' time, and if the proportional increase in earnings caused by this additional schooling is constant over the lifetime, then the log of earnings would be linearly related to individuals' years of schooling, with the slope equal to the rate of return to investment in education.² He augmented this model to include a quadratic term in work experience to allow for

¹ Early references are Gorseline (1932), Walsh (1935), Miller (1955), and Wolfe and Smith (1956).

² This insight is also in Becker (1964) and Becker and Chiswick (1966) who specify the investment in human-capital cost as a function of earnings that would have been received if the investment were not made.

returns to on-the-job training, yielding the familiar Mincerian wage equation:

$$\ln W_i = \beta_0 + \beta_1 S_i + \beta_2 X_i + \beta_3 X_i^2 + \varepsilon_i \quad (1)$$

where $\ln W_i$ is the natural log of the wage for individual i , S_i is years of schooling, X_i is experience (usually measured as age minus education minus 6), X_i^2 is experience squared, and ε_i is a disturbance term. With Mincer's assumptions, the coefficient on schooling, β_1 , equals the discount rate, because schooling decisions are made by equating two present value earnings streams: one with a higher level of schooling and one with a lower level. An attractive feature of Mincer's model is that time spent in school (as opposed to degrees) is the key earnings determinant, so data on years of schooling can be used to estimate a comparable return to education in countries with very different education systems.

There are other theoretical models that could yield a log-linear earnings-schooling relationship. For example, if the underlying production function between human capital and earnings is log-linear, and individuals randomly choose their level of schooling (e.g., optimisation errors), then the coefficient from equation (1) would uncover the education production function. The slope of the earnings-education gradient would then vary with the quality of education (see Behrman and Birdsall, 1983; and Card and Krueger, 1996).

The Mincerian earnings function is one of the great success stories of empirical economics. Equation (1) has been estimated for most countries of the world by OLS, and the results generally yield estimates of β_1 ranging from .05 to .15, with slightly larger estimates for women than men (see Psacharopoulos, 1994). A coefficient of .05, for example, should be interpreted as meaning that acquiring an additional year of education is associated with 5% higher earnings, other things being equal. Figure 1 scatter diagrams for the US, Sweden, West Germany, and East Germany illustrate that the log-linear relationship also provides a good fit to the data.³

³ German figures are from Krueger and Pischke (1995). American and Swedish figures are based on the authors' calculations using the 1991 *March Current Population Survey* and the 1991 *Swedish Level of Living Survey*. Regressions also include controls for a quadratic in experience and sex.

Figure 1. Unrestricted schooling-log wage relationship and Mincer earnings specification for the US, Sweden, West Germany, and East Germany

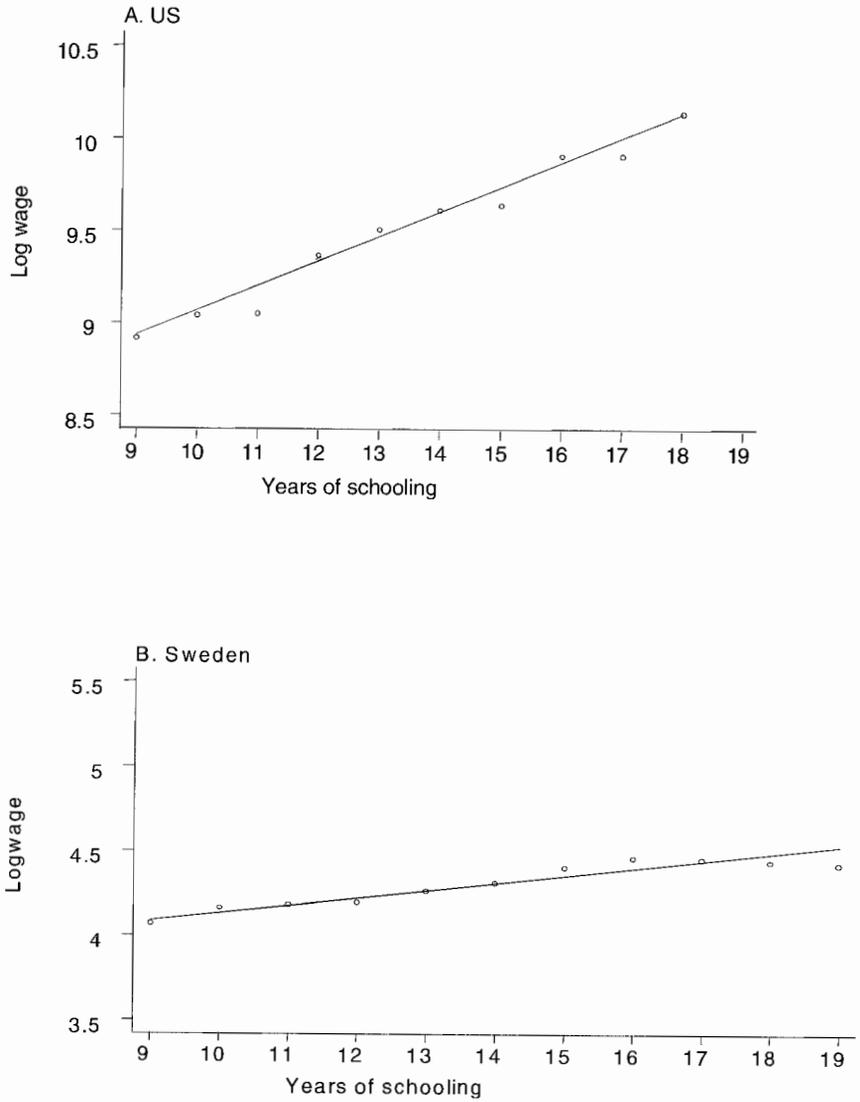
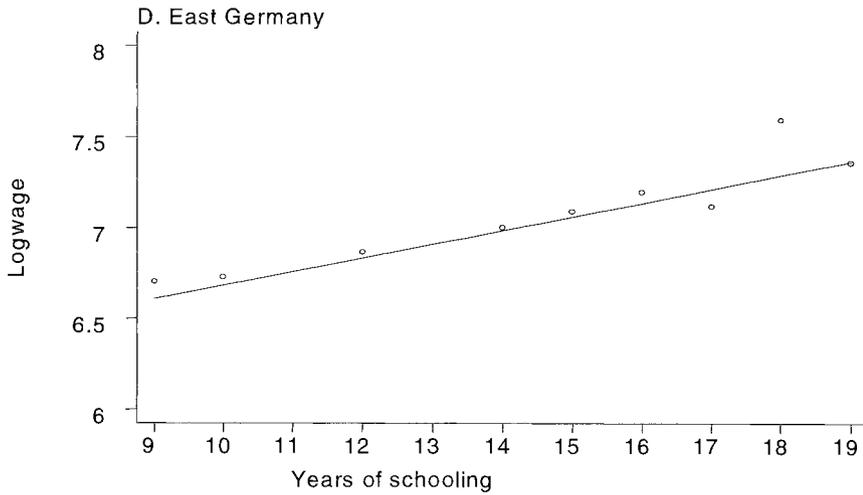
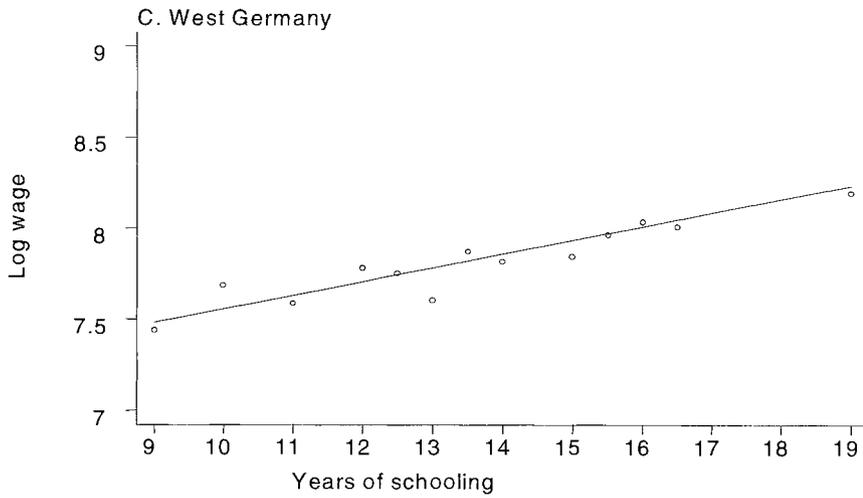


Figure 1. continued ...



These figures display the coefficient on dummy variables that indicate each year of schooling (controlling for experience and gender) and the OLS estimate of the Mincerian return. It is apparent that the semi-log specification provides a good description of the data even in countries with dramatically different economic and education systems.⁴ Notice also that in Sweden, the slope of the relationship between earnings and education is relatively flat, probably a result of institutional forces that compress wage dispersion in Sweden.

Much research has addressed the question of how to interpret the slope of the education variable in equation (1). Does it reflect unobserved ability and other characteristics that are correlated with education, or the true reward that the labour market places on education? Is education rewarded because it is a signal of ability (Spence, 1973), or does the labour market value education because it increases productive capabilities? Is the social return to education higher or lower than the coefficient on education in the Mincerian wage equation? Would all people reap the same proportionate increase in their earnings from attending school an extra year, or does the return to education vary systematically with individual characteristics?

Definitive answers to these questions are not available, although the weight of the evidence clearly suggests that education is not merely a proxy for unobserved ability. For example, Griliches (1977) concludes that instead of finding the expected positive ability bias in the return to education, “The implied net bias is either nil or negative” once measurement error in education is taken into account. The more recent evidence from natural experiments also supports this conclusion.

⁴ Evaluating micro data for states over time in the US, Card and Krueger (1992) find that the earnings-schooling relationship is flat until the level of education reached by the 2nd percentile of the education distribution, and then it becomes log-linear. There is also some evidence of sheepskin effects around college and high school completion (e.g., Park, 1994). Although statistical tests often reject the log-linear relationship for a large sample, the figures clearly show that the log-linear relationship provides a good approximation to the functional form. It should also be noted that Murphy and Welch (1990) find that a quartic in experience provides a better fit to the data than a quadratic.

Table 1 summarises estimates of the return to education based on natural experiments. A hallmark of these studies is that the variations in educational attainment used to identify the return to education stem from a known and arguably exogenous source. For example, Angrist and Krueger (1991) observe that the combined effect of school starting-age cut-offs and compulsory schooling laws produces a natural experiment, in which people who are born on different days of the year, start school at different ages and then reach compulsory-schooling age at different grade levels. If the date of the year people are born is unrelated to their inherent abilities, then, in essence, variations in schooling associated with birth date provide a natural experiment for estimating the benefit of obtaining extra schooling in response to compulsory schooling laws.

Using a sample of nearly one million observations from US censuses, Angrist and Krueger find that men born early in the calendar year, who start school at a relatively older age and can drop out in a lower grade, tend to obtain less schooling. This pattern only applies to those with a high school education or less, consistent with the view that compulsory schooling is responsible for the pattern. They also find that the *pattern of earnings by quarter-of-birth* is mirrored by the *pattern of education by quarter-of-birth*, i.e., people who are born early in the year tend to earn less, on average.⁵ Instrumental variables (IV) estimates that are identified by variability in schooling associated with quarter-of-birth suggest that the payoff to education is slightly higher than the OLS estimate.⁶ Angrist and Krueger conclude that the upward bias in the return to schooling is about the same order of magnitude as the downward bias due to measurement error in schooling.

⁵ Again, no such pattern holds for college graduates.

⁶ Bound, Jaeger and Baker (1995) argue that Angrist and Krueger's IV estimates are biased toward the OLS estimates because of weak instruments. But Staiger and Stock (1997), Donald and Newey (1997), Angrist, Imbens and Krueger (1998), and Chamberlain and Imbens (1996) show that weak instruments do not account for the central conclusion of Angrist and Krueger (1991).

Table 1. OLS and IV estimates of the return to education ...

Study	Sample, identification strategy, and instruments
1. Angrist & Krueger ('91)	'70 & '80 census data. Men. Instruments are quarter of birth interacted with year of birth. Controls include quadratic in age & indicators for race, marital status, & urban residence.
2. Kane & Rouse ('93)	NLS class of '72. Women. Instruments are tuition at two- & four-year state colleges & distance to nearest college. Controls include race, part-time status, & experience. Schooling is measured in units of college credit equivalents.
3. Card ('95a)	NLS young men ('66 cohort). Instrument is an indicator for a nearby four-year college in '66 or the interaction of this variable with parental education. Controls include race, experience (treated as education), region, & parental education.
4. Conneely & Uusitalo ('98)	Finnish men who served in the army in '82 & were working full time in civilian jobs in '94. Administrative earnings & education data. The instrument is dummy for living in university town in '80. Controls include quadratic in experience & parental education & earnings.
5. Maluccio ('97)	<i>Bicol Multipurpose Survey</i> (Philippines). Male & female wage earners ages 20-44 in '94, whose families were interviewed in '78. Instruments are distance to nearest high school (HS) & indicator for local private HS. Controls include quadratic in age & indicators for gender & residence in a rural community.
6. Harmon & Walker ('95)	<i>British Family Expenditure Survey</i> '78-86. Men. Instruments are indicators for changes in the minimum school-leaving age in '47 & '73. Controls include quadratic in age, survey year, & region.
7. Ichino & Winter-Ebmer ('98)	German Socio-economic Panel '86. Men. Instrument is indicator for cohort born '30-35 &/or whether father served in World War II. Controls include a quadratic in age, unemployment rate at age 14 & indicators for father's education, socio-economic status, & self-employed status. Returns were calculated based on assumption of four years of high school.
8. Lemieux & Card ('98)	Austrian microcensus '83. Men born after '46. Instrument is indicator for cohort born '30-35. Controls include age & unemployment rate at age 14. '71 & '81 Canadian census. '73 <i>Job Mobility Survey</i> . Men, World War II veterans from Quebec (French speaking) & Ontario (English speaking). Instruments are potential eligibility for World War II education assistance program or an interaction between this & father's education. Controls include quadratic in potential experience & dummy for Quebec (rows 1 & 2) or quadratic in actual experience, dummy for Quebec, served in World War II & father's education (row 3).
9. Butcher & Case ('94)	<i>US Panel Study of Income Dynamics</i> . White women ages 24-65 in '85. Instruments are indicators for the presence of sisters or sisters' indicator & quadratic in number of siblings. Controls include a cubic in age, indicators for Catholic, oldest child, poor household, & parental education.
10. Duflo ('98)	'95 <i>Intercensal Survey of Indonesia</i> . Men born between '50-72. Instruments are interactions between indicators for age in '74 & some measure of the program intensity in region born, capturing the effect of a large-scale governmental primary school program. Controls include indicators for year & region of birth & indicators for year of birth, interacted with number of children & with enrolment rate in '71.
11. Meghir & Palme ('99)	'91 <i>Swedish Level of Living Survey</i> ; 427 men born between '45-55. Instrument is an indicator of whether the individual was born in a municipality, which implemented a compulsory schooling increase for that cohort. Controls include father's education, cohort & region dummies.

... with instruments based on natural experiments.

Description	Schooling coefficients		Hausman test (p-value)
	OLS	IV	
1920-29 cohort in 1970	.070 (.000)	.101 (.033)	.348
1930-39 cohort in 1980	.063 (.000)	.060 (.030)	.920
1940-49 cohort in 1980	.052 (.000)	.078 (.030)	.386
Models without test score or parental education	.080 (.005)	.091 (.033)	.736
Models with test scores & parental education	.063 (.005)	.094 (.042)	.457
Models using college proximity as instrument (1976 earnings)	.073 (.004)	.132 (.049)	.227
Models using college proximity X family background as instrument	--	.097 (.048)	.616
Models that exclude parental education & earnings	.085 (.001)	.110 (.024)	.297
Models that include parental education & earnings	.083 (.001)	.098 (.035)	.668
Models without control for selection of employment status or location	.073 (.011)	.145 (.041)	.068
Models with selection correction for location & employment status	.063 (.006)	.113 (.033)	.123
	.061 (.001)	.153 (.015)	.000
Models using 1930-35 cohort as instrument	.072 (.008)	.148 (.211)	.721
Models using father in World War II as instrument	--	.182 (.070)	.113
Models using 1930-35 cohort & father in World War II as instruments	--	.177 (.070)	.131
Models using 1930-35 cohort as instrument	.130 (.004)	.237 (.086)	.211
1971 Canadian census. Models using potential program eligibility as instrument.	.070 (.002)	.141 (.048)	.139
1981 Canadian census. Models using potential program eligibility as instrument.	.062 (.001)	.055 (.016)	.661
1973 Job Mobility Survey. Models using potential program eligibility interacted with father's education as instrument.	.065 (.003)	.140 (.091)	.410
Models using indicator for presence of sister as instrument	.091 (.007)	.184 (.113)	.410
Models using indicator for presence of sister & quadratic in no. of siblings as instruments	--	.182 (.055)	.095
Model using no. of schools/child built in 1973-78 as measure of program intensity	.062 (.001)	.097 (.034)	.303
Model using compulsory schooling differences across areas & cohorts to identify the return to schooling	.028 (.007)	.036 (.021)	.72

Table 1 notes: Rows 1-6 are adapted from Card (1998); rows 7-10 are authors' summaries. In row 7, estimates and standard errors are divided by 4 to approximate the yearly returns to schooling. Hausman tests of the equality of OLS and IV estimates are based on authors' calculations; test in row 10 is only approximate because the models are not identical.

Other studies listed in Table 1 use different sources of variability in schooling. Harmon and Walker (1995) more directly examine the effect of compulsory schooling by studying the effect of changes in the compulsory schooling age in the UK. Card (1995a) exploits variations in schooling attainment owing to families' proximity to a college in the US. The evidence summarised in the table is from several countries and generally supports the conclusion that the private return to education is at least as great as simple OLS estimates would suggest.

Specific evidence for Sweden is more limited but suggests that the private payoff to education in Sweden is positive but lower than in most of the rest of the world. For example, Kjellström (1997) uses registered earnings data to estimate the payoff to years of schooling in 1991 for men. Controlling for family background, experience, grades, and test scores at ages 12-13, he finds that the return to a year of education varies between .037 and .051, depending on the birth cohort. Using data on earnings for identical twins in 1987, 1990, and 1993, Isacson (1999) finds that the cross-twin OLS estimate of the return to education is .046 and that the within-twin estimate is .022. But when he adjusts the within-twin estimate for measurement error in education, the return rises to .042, which suggests little downward ability bias. Similar to the US literature, Ottersten, et al. (1996) find that the return to education in Sweden falls by about 10% when they estimate a parametric sample selection model. Meghir and Palme (1999) find that the return to years of education stemming from increases in compulsory schooling is about the same order of magnitude as the cross-sectional estimate of the return to schooling in Sweden (see last row of Table 1). They also find evidence that men with higher ability tend to receive higher returns to education. Using cross-sections from the Swedish *Level of Living Surveys*, Palme and Wright (1999) find that the payoff to education fell for men and women from .08 in 1968 to .03-.04 in 1981 and stayed roughly constant between 1981 and 1991. Edin and Holmlund (1995) also find that the college/high school wage differential (before and especially after tax) fell considerably between 1968 and 1984 and then rose

gradually between 1984 and 1991. In sum, these studies paint a picture of education in Sweden that is broadly similar to the rest of the world: the OLS estimate of the return to education does not seem severely affected by ability bias, although the payoff workers gain from attaining additional education in Sweden is lower than in most other countries that were carefully studied.

1.2. Differences in the payoff to human capital across groups

The studies in Table 1 typically find somewhat higher estimates of the return to schooling when variability in schooling from exogenous circumstances is used to estimate the return than when all variability is used. Although the difference between the OLS and IV estimates is not statistically significant in most of the studies, there is at least a hint that students who complete more schooling than they would ordinarily choose earn a higher return for that schooling than others do from the years they voluntarily selected. Ashenfelter, Harmon and Oosterbeek (1998) assemble estimates from many of the studies in the literature and find that the average conventional OLS return to schooling is .065, whereas the average IV estimate is .086.

One possible explanation for the tendency of IV estimates to exceed OLS estimates is that IV estimates are probably published when they obtain statistically significant, positive coefficients, because there is a presumption that the return to schooling should be positive. Because the IV studies tend to have relatively imprecise estimates, there may be a selection process at work, which leads to an overrepresentation of IV studies with relatively large returns to education in the literature: a larger coefficient is required to have a significant t-ratio, the larger the standard error. Ashenfelter, Harmon and Oosterbeek (1998) provide some evidence for this type of selection by showing that the return to education from various IV estimates is positively related to the standard error of the estimates; absent some form of selection, there is no reason to expect the true return to education to be correlated with its standard error. But once they adjust for this form of selection bias, they still find that the return to education is higher in the IV estimates, on average, than in the OLS estimates (.080 versus .065).

We tentatively conclude from this evidence that the return to an additional year of education obtained for reasons such as compulsory schooling is more likely to be greater than, than less than, the conventionally estimated return to schooling. Because the levels of

schooling of people who are from more disadvantaged backgrounds tend to be those who are most affected by the interventions examined in Table 1, Card (1995b) and others have concluded that the return to an additional year of schooling would be higher for individuals from disadvantaged families than for those from advantaged families.

Other related evidence for the US suggests the payoff to investments in education might be higher for more disadvantaged youth. First, while studies of the effect of school resources on student outcomes yield mixed results, there is a tendency to find more beneficial effects of school resources on more disadvantaged students (see, for example, Summers and Wolfe, 1977; Krueger, 1999; and Rivkin, Hanushek and Kain, 1998). Second, evidence suggests that pre-school programs have particularly large, long-term effects for disadvantaged children in terms of reducing crime and welfare dependence and raising incomes (see Barnett, 1992). Third, several studies have found that students from advantaged and disadvantaged backgrounds make equivalent gains on standardised tests during the school year, but children from disadvantaged backgrounds fall behind during the summer, while children from advantaged backgrounds move ahead (see Entwisle, Alexander, and Olson, 1997). And fourth, recent evidence suggests that college students from more disadvantaged families benefit more from attending elite colleges than students from advantaged families (see Dale and Krueger, 1998).

Another finding from the US that may have some bearing on Sweden concerns adult education and training. Studies of job training programs that use randomised design have typically found modest payoffs for disadvantaged adult males and larger payoffs for disadvantaged women (see, e.g., LaLonde, 1995).⁷ Evidence on formal adult education is less extensive but also suggests normal rates of return to adults who return to school after being displaced. For example, Jacobson, LaLonde and Sullivan (1997) study the experience of workers in Pennsylvania and Washington, who lost jobs that they held for three or more years, and then entered a community college. Typically, workers completed eight months to one year of education. They found that the trainees' earnings increased by 2-5% more than other workers who did not enter a community college, but the payoff was substantially higher for those who prepared for jobs in certain

⁷ Evidence on training effects for Sweden is consistent with the US experience; see, for example, Forslund and Krueger (1997).

technical fields and the health professions. Angrist and Newey (1991) also find that the increase in earnings experienced by young men who returned to school after entering the labour market is about as large as conventional estimates of the payoff to education.

It is unclear if the evidence of a higher return to human capital for disadvantaged youth applies outside the US. But in all regions of the world, Psacharopoulos (1995) concludes that there is a higher return to primary schooling than to secondary or tertiary schooling, which also suggests disadvantaged children benefit most from additional human-capital investments.

1.3. Theoretical reasons for a higher return for investments in disadvantaged groups

If one tentatively accepts the finding that the return to investments in human capital is higher for less advantaged people, what might explain such a phenomenon? Card (1995b) and Lang (1993) present models in which people from lower income households have higher discount rates. Because people select their level of schooling by equating the payoff to schooling to the discount rate, people from low-income households naturally have higher returns to schooling in these models.

We would propose a complementary explanation, which can also encompass the related facts about the return to human capital for disadvantaged groups previously mentioned. In particular, recognise that children acquire human capital from many sources, including parents, teachers, and classmates. To some extent, human capital from these sources might be substituted. If, for example, a person from a high-income family receives poor reading instruction at school, the family may compensate by providing tutoring. Low-income families have less scope to substitute home resources for schooling resources and have home environments that are less conducive to learning, which might explain why pre-school programs are successful for these students. It might also be the case that the education production function is concave, so students who are at the low end of the ability distribution, because of their endowments, benefit more from additional human capital than students at the high end.

Inherently, both these explanations rely on some form of imperfect capital markets because, if families were not constrained, they would invest in human capital until the point at which the marginal

benefit equals the (universal and constant) marginal cost. But there are reasons to doubt that the supply of funds for investing in human capital is infinitely elastic at the market rate for all families. Many authors have noted that future human capital cannot be used to collateralise loans because of moral hazard problems. Perhaps more importantly, poorly endowed families may underestimate the value of education—after all, education is purchased to improve information and decision-making, and those with a low level of education may be particularly susceptible to making suboptimal decisions.

1.4. Social versus private returns to education

Thus far, the discussion has focused on the private return to education. The social return can be higher or lower than the private return. The social return can be higher because of externalities from education, which could occur, for example, if higher education leads to technological progress that is not captured in the private return to that education, or if more education produces positive externalities, such as a reduction in crime and welfare participation, or more informed political decisions. The former is more likely if human capital is expanded at higher levels of education, while the latter is more likely if it is expanded at lower levels of education. It is also possible that the social return to education is less than the private return. For example, Spence (1973) and Machlup (1970) note that education could just be a credential, which does not raise people's productivity. It is also possible that in some developing countries, where higher education has been associated with higher unemployment (e.g., Blaug, Layard and Woodhall, 1969) and the return to physical capital may exceed the return to human capital (e.g., Harberger, 1965), increased levels of education may reduce total output.

Most of the micro human-capital literature focuses on the private rather than social return to education, but the finding of little ability bias in the Mincerian wage equation casts doubt on at least some forms of credential arguments. The possibility of externalities to education motivates much of the macro growth literature, to which we now turn.

2. Macro growth equations

Now, if education produces not only differences in individual capacities but also new knowledge resulting in continuous technological, managerial and organisational improvements, the growth in national product due to these improvements can reasonably be regarded as an additional contribution of education.

—Fritz Machlup, 1970

If, as Griliches (1977) observed, the micro human-capital earnings function spawned “a vast river of econometric studies threatening to engulf us all,” then it could be argued that the new macro growth literature has generated a Tsunami of cross-country regression studies threatening to wash us all away. The literature is voluminous. We do not attempt an exhaustive review here. Instead, we summarise the main findings and explore the impact of several econometric issues.

The macro growth literature yields three different conclusions from the micro literature. First, the initial human-capital stock matters, not the change in human capital. Second, secondary and post-secondary education matter more for growth than primary education. Third, female education has an insignificant and sometimes negative effect on economic growth.

2.1. The Mincer model and the macro growth model

The typical macro growth model estimated in the literature is motivated by the convergence literature. This leads to interest in estimating parameters of an underlying model such as: $\Delta y_j = \alpha_j - \beta(y_{j,t-1} - y_j^*) + \mu_j$, where Δy_j denotes the annualised change in log GDP per capita in country j between $t-1$ and t , α_j denotes country j 's steady-state growth rate, $y_{j,t-1}$ is the log of initial GDP per capita, y_j^* is steady-state log GDP per capita, and β measures the speed of convergence to steady-state income. The intuition for this equation is straightforward: countries that are below their steady-state income level should grow quickly, and those that are above it should grow slowly. A prototypical estimating equation is:

$$\Delta y_j = \beta_0 + \beta_1 y_{j,t-1} + \beta_2 S_{j,t-1} + \beta_3 Z_{j,t-1} + \varepsilon_j \quad (2)$$

where Δy_t is the change in log GDP per capita from year $t-1$ to t , S_{t-1} is average years of schooling in the population in the initial year, y_{t-1} is the log of initial GDP per capita, and Z_{t-1} includes variables such as inflation, capital, or the rule-of-law index.⁸ Sometimes equation (2) also includes an interaction between years of schooling and initial log GDP, to allow the convergence rate to vary across countries with different levels of education. Also note that schooling is sometimes specified in logarithmic units in equation (2). Barro and Sala-i-Martin (1995), Benhabib and Spiegel (1994), and others conclude that the change in schooling has an insignificant effect if it is included in a GDP growth equation even though this variable is predicted to matter in the Mincer model and in some endogenous economic growth models (e.g., Lucas, 1988). Equation (2) is typically estimated with data for a cross-section or pooled sample of countries spanning a 5-, 10-, or 20-year period.

The Mincer model in equation (1) can be aggregated to the country level, yielding what Heckman and Klenow (1997) call the *macro Mincer model*. The dependent variable of the macro Mincer model is the log of the geometric earnings mean, and the key explanatory variable is mean years of schooling (taken over all levels) for the work force. If this equation holds in year t and $t-1$, differences over time can be taken for each country, and the countries can be pooled together. The first-differenced macro-Mincer equation differs from the macro growth equation typically estimated in the literature in several respects. First, the macro growth models use the change in log GDP per capita as the dependent variable, rather than the change in the log earnings mean. If income has a log normal distribution with a constant variance over time, and if labour's share is also constant, then aggregating GDP in this way would not matter.⁹ Second, and probably more importantly, the macro growth literature typically omits the change in schooling. Third, because convergence issues motivate the macro models, they include the initial GDP level, capital, and correlates for steady-state income. A primary motivation for including human-capital variables at all in these equations is to control for y^* .

⁸ Henceforth, we use the terms GDP per capita and GDP interchangeably.

⁹ Heckman and Klenow (1997) also point out that half the variance of log income will be added to the GDP equation if income is log-normal. See Heckman and Klenow (1997) for cross-sectional evidence.

There are at least six ways to interpret the coefficient on the initial level of schooling in equation (2):¹⁰

1. Schooling may be a proxy for steady-state income. Countries with higher levels of schooling conditional on their initial GDP would be expected to have higher steady-state income (perhaps because physical capital is easier to obtain than human capital), so we would expect countries with higher average levels of education to grow more ($\beta_2 > 0$). If this were the case, more schooling would not change the steady-state growth rate, although it would raise steady-state income.
2. Schooling could change the steady-state growth rate by enabling the work force to develop, implement, and adopt new technologies (see Nelson and Phelps, 1966; Welch, 1970; and Romer, 1990), again leading to the prediction $\beta_2 > 0$.
3. Countries with low initial stocks of human capital could have greater opportunities to grow by implementing technology developed abroad. In this case, one would expect $\beta_2 < 0$.
4. A positive (or negative) coefficient on initial schooling may simply reflect an exogenous, world-wide increase (or decrease) in the return to schooling (see Krueger and Lindahl, 1998); here, countries with a high initial level of schooling will naturally grow faster (slower).
5. Anticipated increases in future economic growth could cause schooling to rise (i.e., reverse causality), as argued by Bils and Klenow (1998).
6. The schooling variable may pick up the effect of the change in education, which is omitted from the equation.

Sorting through these explanations is difficult. Topel (1998) argues that “little can be learned” from macro growth equations because either a positive or negative coefficient on initial human capital is “consistent with the idea that human capital is a boon to growth and development.”

¹⁰ The first three of these interpretations are adapted from Topel (1998). Barro (this volume) emphasises the first two explanations.

2.2. Basic results and effect of measurement error

Table 2 replicates and extends the growth accounting and endogenous growth regressions in Benhabib and Spiegel's influential paper.¹¹ Their analysis is based on Kyriacou's (1991) measure of average years of schooling for the work force in 1965 and 1985, Summers and Heston's GDP and labour force data, and a measure of physical capital derived from investment flows. Following Benhabib and Spiegel, the regression in column 1 relates the annualised growth rate of GDP to the log change in years of schooling. From this model, Benhabib and Spiegel conclude, "Our findings shed some doubt on the traditional role given to human capital in the development process as a separate factor of production." Instead, they conclude that the stock of schooling matters for growth (see column 2 and 5) by enabling countries to adopt and implement technology faster.

Topel argues that Benhabib and Spiegel's finding of an insignificant and wrong-signed effect of schooling changes on GDP growth is due to their log specification of education. The log-log specification follows if one assumes that schooling enters an aggregate Cobb-Douglas production function linearly. Given the success of the Mincer model, however, we would agree with Topel that it is more natural to specify human capital as an exponential function of schooling in a Cobb-Douglas production function, so the change in years of schooling would enter the growth equation linearly. In any event, the logarithmic specification of schooling does not fully explain the perverse effect of education improvements on growth in Benhabib and Spiegel's analysis.¹² Results of estimating a linear education specification in column 4 still show a statistically insignificant (though positive) effect of the linear change in schooling on economic growth.

¹¹ We were unable to exactly replicate Benhabib and Spiegel's results because we use a revised version of Summers and Heston's GDP data. Nonetheless, our estimates are very close to theirs. For example, Benhabib and Spiegel report coefficients of -.059 for the change in log education and .545 for the change in log capital when they estimate the model in column 1 of Table 1; our estimates are -.072 and .523. Some of the other coefficients differ because of scaling; for comparability with later results, we divided the dependent variable and other variables measured in changes by 20.

¹² The log specification is part of the explanation, because if the model in column 3 is estimated without the initial level of schooling, the change in log schooling has a negative and statistically significant effect, whereas the change in the level of schooling has a positive and statistically significant effect if it is included as a regressor in this model instead.

Table 2. Replication and extension of Benhabib and Spiegel (1994). Dependent variable: annualised change in log GDP, 1965-85.

Variable	Log schooling			Linear schooling		
	(1)	(2)	(3)	(4)	(5)	(6)
$\Delta \text{Log } S$	-.072 (.058)	.178 (.112)	.614 (.162)	--	--	--
$\text{Log } S_{65}$	--	.010 (.004)	.026 (.005)	--	--	--
ΔS	--	--	--	.012 (.023)	.039 (.024)	.151 (.034)
S_{65}	--	--	--	--	.003 (.001)	.004 (.001)
$\text{Log } Y_{65}$	-.009 (.002)	-.012 (.002)	-.015 (.003)	-.008 (.002)	-.014 (.002)	-.014 (.004)
$\Delta \text{Log capital}$.523 (.048)	.461 (.052)	--	.521 (.051)	.465 (.052)	--
$\Delta \text{Log work force}$.175 (.164)	.232 (.160)	--	.110 (.160)	.335 (.167)	--
R^2	.694	.720	.291	.688	.726	.271

Notes: All change variables were divided by 20, including the dependent variable. Sample size is 78 countries. Standard errors are in parentheses. All equations also include an intercept. S_{65} is Kyriacou's measure of schooling in 1965; $\Delta \text{Log } S$ is the change in log schooling between 1965 and 1985, divided by 20; and Y_{65} is GDP per capita in 1965. Mean of dependent variable is .039; standard deviation of dependent variable is .020.

Columns 3 and 6 show that controlling for capital is key to Benhabib and Spiegel's finding of an insignificant effect of the change in schooling variable. When physical capital is excluded from the growth equation, the change in schooling has a statistically significant and positive effect in either the linear or log schooling specification. Why does controlling for capital have such a large effect on education? As the following discussion shows, it appears that the insignificant effect of the change in education is a result of the extraordinarily low signal in the education change variable. Conditional on the other variables that Benhabib and Spiegel hold constant (especially capital), the change in schooling conveys virtually no signal. If the observed changes in schooling in these data consist purely of random mistakes due to imprecise measures of education, then one would not expect

countries who mistakenly appear to have increased their levels of schooling to grow any faster due to the increased measured schooling.

Notice also that the coefficient on capital is high in Table 2, about .50 with a t-ratio close to 10. In a competitive, Cobb-Douglas economy, the coefficient on capital growth in a GDP growth regression should equal capital's share of national income. Gollin (1998) estimates that labour's share ranges from .65 to .80 in most countries, after allocating labour's portion of self-employment and proprietors' income. Consequently, capital's share is probably no higher than .20 to .35. Because measured capital is derived from investment flows, and GDP is a direct function of investment, errors in the investment data will mechanically bias the coefficient on the growth in capital upwards; this might explain why capital has such a large and significant coefficient in the growth equations. If the coefficient on capital growth in column 5 of Table 2 is constrained to equal .20 or .35—a plausible range for capital's share—the coefficient on the schooling change rises to .09 or .06, and becomes statistically significant.

2.2.1. The extent of measurement error in international education data

Random measurement errors in the education data have the same impact on regression estimates as static does on radio reception: they make it harder to detect the message that is being transmitted in the data. Measurement error in the education data used for cross-country regressions arises because years of schooling are an imperfect measure of human capital, and because available cross-country data on average years of schooling are measured with error. We focus on the latter problem, although the former may also be significant. Kyriacou (1991) derived the measure of average years of schooling for the work force used by Benhabib and Spiegel as follows. First, survey-based estimates of average years of schooling for 42 countries in the mid-1970s were regressed on the countries' primary, secondary, and tertiary school enrolment rates. Coefficient estimates from this model were then used to predict years of schooling from enrolment rates for countries in other years. This method is likely to generate substantial noise because the fitted regression may not hold for all countries and time periods, and enrolment rates are frequently measured inaccurately. Changes in education derived from this measure are likely to be particularly noisy. Benhabib and Spiegel use Kyria-

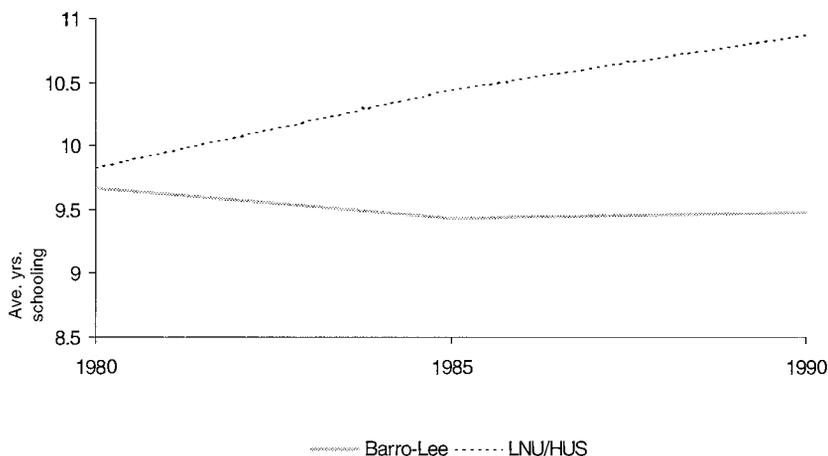
cou's education data for 1965, and the change between 1965 and 1985.

The widely used Barro and Lee (1993) data set is an alternative education data source. For 40% of country-year cells, Barro and Lee measure average years of schooling by survey and census-based estimates reported by UNESCO (each country had at least one survey or census estimate). The remaining observations were derived from historical enrolment flow data using a *perpetual inventory method*. The Barro-Lee measure is undoubtedly an advance over existing international education-attainment measures, but errors in measurement are inevitable because the UNESCO enrolment rates are of doubtful quality in many countries (see Behrman and Rosensweig, 1994). Additionally, students educated abroad are miscounted in the flow data, which is probably a larger problem for higher education. More fundamentally, secondary and tertiary schooling is defined differently across countries, so the data for secondary and higher schooling are probably noisier than overall schooling. Notice also that because errors cumulate over time in Barro and Lee's stock-flow calculations, the errors in education will be positively correlated over time.

Even developed countries' data are sometimes measured with error in the available data sets. For example, as illustrated in Figure 2, the Barro-Lee data set indicates that average educational attainment declined by 0.2 years in Sweden between 1980 and 1990. This finding conflicts with other Swedish data, which show rising educational attainment and enrolment in this period. Between 1980 and 1990, for example, the Swedish *Level of Living Survey* (LNU) indicates that the average number of years of education for those ages 18-75 increased by just over one year. Different education trends (as well as different mean levels of education) displayed in Figure 2 may reflect:

- The fact that 8.7 per cent of the population in Sweden reported that they completed a major part of their education abroad (according to the 1991 LNU survey)
- The recent emphasis on increasing the educational attainment of adults in Sweden.

Figure 2. Average years of schooling in Sweden, Barro-Lee versus other survey data.



Notes: Barro-Lee data are for population ages 15 and older; 1980 and 1991 survey data are from Swedish *LNU*, and 1984 survey data are from *Household Market and Nonmarket Survey* (*HUS*). *LNU* and *HUS* pertain to the population ages 18-75.

We can estimate the reliability of the Barro-Lee and Kyriacou data if we treat the two variables as independent education-attainment estimates. Under standard assumptions, the *reliability ratio* gives an estimate of the *attenuation bias* in the estimated education coefficient from a bivariate regression when education is the explanatory variable (see Griliches, 1986; and Angrist and Krueger, 1999). The education data are likely to be much less reliable when they are expressed in changes rather than in levels, because much more of the signal than noise in the data is likely to cancel out when differences are taken. Table 3 presents estimates of the reliability ratio of the Kyriacou and Barro-Lee education data. The reliability ratios were derived by regressing one measure of years of schooling on the other.¹³ The cross-sectional data have considerable signal, with the reliability ratio ranging from .77 to .85 in the Barro-Lee data, and exceeding .96 in the Kyriacou

¹³ Barro and Lee (1993) compare their education measure with alternative series by reporting correlation coefficients. For example, they report a correlation of .89 with Kyriacou's education data and .93 with Psacharopoulos'. Our cross-sectional correlations are not very different. They do not report correlations for changes in education.

data. The reliability ratios fall by 10 to 30% if we condition on the log of 1965 GDP per capita, which is a common covariate. More disconcerting, when the data are measured in changes over the 20-year period, the reliability ratio for the data used by Benhabib and Spiegel falls to less than 20%, and to 58% in the Barro and Lee data. By way of comparison, note that Ashenfelter and Krueger (1994) find that the reliability of self-reported years of education is .90 in micro data on workers, and that the reliability of self-reported differences in education between identical twins is .57.

Table 3. Reliability of various years-of-schooling measures, estimated reliability ratios for Barro-Lee and Kyriacou data.

	Reliability of Barro-Lee data	Reliability of Kyriacou data
Average years of schooling, 1965	.851 (.049)	.964 (.055)
Average years of schooling, 1985	.773 (.055)	.966 (.069)
Change in years of schooling, 1965-85	.577 (.199)	.195 (.067)

Notes: The estimated reliability ratios are the slope coefficients from a bivariate regression of one measure of schooling on the other. For example, the .851 entry in the first row is the slope coefficient from a regression in which the dependent variable is Kyriacou's schooling variable and the independent variable is Barro-Lee's. Sample size is 68 countries. Standard errors are reported in parentheses.

These results suggest that if there were no other controls, the estimated effect of schooling changes in Benhabib and Spiegel's results would be biased downward by 80%. But the bias is probably even greater because their regressions include additional explanatory variables that soak up some of the true changes in schooling. We estimate that none of the observed changes in education represent true changes in education once capital growth is held constant. Instead of rejecting the traditional Mincerian role of education on growth, a more plausible interpretation is that Benhabib and Spiegel's results shed no light on the role of education changes on growth because the data contain no signal.

The Barro and Lee data convey more signal than Kyriacou's data when expressed in changes. Nearly 60% of the variability in observed changes in years of education in the Barro-Lee data represent true

changes. This makes the Barro-Lee data preferable to use to estimate the effect of education improvements. Despite the greater reliability of the Barro-Lee data, there is still little signal left over in these data, conditional on the other variables in the models in Table 2. Conditional on capital growth, population growth, and initial schooling and GDP, only about 40% of the remaining variability in schooling changes in the Barro-Lee data is due to true signal.

Using data on average education for 34 countries from the *World Values Survey* (WVS), in Krueger and Lindahl (1998), we find that all years of education in the Barro-Lee data are measured more accurately than secondary and higher education. Because countries use different definitions of secondary schooling in the UNESCO data, this finding is not surprising. But it suggests that more accurate results will be obtained if all years of schooling are used to measure human capital.

2.3. Additional growth models

Measurement errors aside, one could question whether physical capital should be included in a GDP growth equation because it is potentially an endogenous variable. Fast-growing countries have more access to investment (see Blomström, Lipsey and Zejan, 1993). Additionally, considerations of the low signal in schooling changes conditional on capital growth, and the mechanical correlation between measured capital and GDP (because capital is typically derived from investment) lead us to prefer parsimonious models that omit capital. Barro (1997) also excludes capital, so there is some precedent for a parsimonious specification in the growth literature. We first report models without controlling for capital and then focus on the effect of capital in long-difference models in Section 2.5. We return to the effect of controlling for additional explanatory variables in Section 3.2.

Table 4 reports stylised macro growth models without controlling for physical capital for samples spanning 5-, 10-, or 20-year periods. The dependent variable is the annualised change in the log of real GDP per capita per year based on Summers and Heston's (1991) Penn World Tables, Mark 5:6. Results are generally similar if GDP per worker is used instead. We use GDP per capita because it reflects labour force participation decisions and because it has been the focus of much of the previous literature. The schooling variable is Barro and Lee's measure of average years of schooling for the population

ages 25 and older. When the change in average schooling is included as a regressor in these models, we divide it by the number of years in the time span so the coefficients are comparable across columns and comparable to Table 2. The equations were estimated by OLS, but the standard errors reported in the table allow for a country-specific component in the error term. We initially exclude other variables (such as the fertility rate and rule-of-law index) that are sometimes included in macro growth models to focus on education and because those other variables are probably influenced by education. Perhaps more importantly, the inclusion of covariates exacerbates measurement error problems. For example, the correlation between the log fertility rate and education is $-.85$ in the Barro-Lee data set, which implies that the relative signal of average schooling falls to only one-third if fertility is held constant (see Krueger and Lindahl, 1998).

Table 4. The effect of schooling on economic growth.
Dependent variable: annualised change in log GDP per capita.

	5-year changes			10-year changes			20-year changes		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
S_{t-1}	.004 (.001)	--	.004 (.001)	.003 (.001)	--	.004 (.001)	.005 (.001)	--	.005 (.001)
ΔS	--	.031 (.015)	.039 (.014)	--	.075 (.026)	.086 (.024)	--	.184 (.057)	.182 (.051)
$\text{Log } Y_{t-1}$	-.005 (.003)	.004 (.002)	-.006 (.003)	-.003 (.003)	.004 (.001)	-.005 (.003)	-.010 (.003)	-.001 (.002)	-.013 (.003)
R^2	.197	.161	.207	.242	.229	.284	.184	.103	.281
N	607	607	607	292	292	292	97	97	97

Notes. First six columns include time dummies. Equations were estimated by OLS. The standard errors in the first six columns allow for correlated errors for the same country in different time periods. Maximum number of countries is 110. Columns 1-3 consist of changes for 1960-65, 1965-70, 1970-75, 1975-80, 1980-85, and 1985-90. Columns 4-6 consist of changes for 1960-70, 1970-80, and 1980-90. Columns 7-9 consist of changes for 1965-85. $\text{Log } Y_{t-1}$ and S_{t-1} are the log GDP per capita and level of schooling in the initial year of each period. ΔS is the change in schooling between $t-1$ and t divided by the number of years in the period. Data are from Summers and Heston and Barro and Lee. Mean (and standard deviation) of annualised per capita GDP growth is .021 (.033) for columns 1-3, .022 (.026) for columns 4-6, and .022 (.020) for columns 7-9.

Our findings parallel Topel's. The change in schooling has little effect on GDP growth when the growth equation is estimated with high-frequency changes (i.e., five years). But increases in average years of schooling have a positive and statistically significant effect on economic growth over periods of 10 or 20 years. Over long periods, the magnitude of the coefficient estimates on the change and initial level of schooling are large, probably too large to represent the causal effects of schooling.

The finding that the time span matters so much for the change in education also suggests that measurement error in schooling plays a major role in these estimates. Over short time periods, there is little change in a nation's true level of schooling, so the transitory component of measurement error in schooling would be large relative to variability in the true change. Over longer periods, true levels of education probably change, increasing the signal relative to the noise in measured changes.

Measurement error bias appears to be greater over the 5 and 10 year horizons, but it is still substantial over 20 years. Because the change in schooling and initial GDP level are essentially uncorrelated, the coefficient on the 20-year change in schooling in column 8 is biased downward by a factor of $1-R_{\Delta S}$, which is about 40% according to Table 3. Thus, adjusting for measurement error would lead the coefficient on the change in education to increase from .18 to $.30 = .18/(1-.4)$. This is an enormous return to investment in schooling, equal to three or four times the private return to schooling estimated within most countries. Moreover, even if labour only captures two-thirds of the rise in GDP associated with an increase in human capital, as is sometimes assumed, the net payoff to labour based on this coefficient is at least double the conventional return to schooling.

Like Benhabib and Spiegel, Barro and Sala-i-Martin (1995) conclude that contemporaneous changes in schooling do not contribute to economic growth, although they note that measurement error in schooling could bias their results. There are four reasons to suspect that measurement error has a particularly acute effect on their estimates. First, Barro and Sala-i-Martin analyse a mixed sample that combines changes over 5-year (1985-90) and 10-year (1965-75 and 1975-85) periods; examining changes over such short periods tends to exacerbate the downward bias due to measurement errors. Second, they examine changes in average years of secondary and higher schooling. As Table 3 shows, the reliability of secondary and higher

schooling is lower than the reliability of all years of schooling, and the changes are likely to be less reliable as well. Third, they include separate variables for changes in male and female years of secondary and higher schooling. These two variables are highly correlated ($r = .85$), which would exacerbate measurement error problems if the signal in the variables is more highly correlated than the noise. If average years of secondary and higher schooling for men and women combined, or years of secondary and higher schooling for either men or women, is used instead of all years of schooling in the 10-year change model in column 6 of Table 4, the change in education has a sizeable, statistically significant effect. Fourth, they estimate a restricted Seemingly Unrelated Regression (SUR) system, which exacerbates measurement error bias because asymptotically, this estimator is equivalent to a weighted average of an OLS and fixed-effects estimator, and it is well known that a fixed-effects estimator exacerbates measurement error bias.

Because Barro (1997) stresses male, secondary and higher education as a key growth determinant, we have also explored the sensitivity of our results to using different measures of education, namely, primary-versus-higher education and male-versus-female education. But we have a preference for measuring schooling by the average of all years of education, because this is the variable specified by the Mincer model and because primary schooling is a pre-requisite for secondary and higher schooling.¹⁴ Focusing only on secondary and higher education is analogous to measuring office capital by only counting the number of stories of buildings above the tenth floor. In any event, when we test for different effects of years of primary and secondary and higher schooling in the model in column 6 of Table 4, we cannot reject that all years of schooling have the same effect on GDP growth (p-value equals .40 for initial levels and .12 for changes). We also find insignificant differences between primary and secondary schooling if we just use male schooling. But we find significant differences if we further desegregate levels of schooling by gender. The initial primary level of schooling has a positive effect for women and a negative effect for men. The initial secondary level of schooling has a negative effect for women and a positive effect for men. The

¹⁴ The macro Mincer model would suggest that average years education of all workers is the appropriate explanatory variable. Because the Barro-Lee data set does not contain schooling just for workers, we use average schooling for the population age 25 and older.

change in primary schooling has a positive effect for women and a negative effect for men, and the change in secondary schooling has a negative effect for women and a positive effect for men. Because levels of schooling are highly correlated for men and women, one must be cautious interpreting regressions that include disaggregated education variables.

Barro (this volume) offers an intriguing explanation for his estimated negative effect of female education on growth: because of gender discrimination, female labour may not be efficiently used in the labour market in many countries. In the extreme, women may be educated but discouraged from joining the labour force, so their human capital does not directly contribute to economic output. To test this hypothesis, we used data from the ILO on labour force participation by gender, and included interactions between gender-specific schooling and gender-specific labour force participation rates in the specification in column 5 of Table 4, and main effects of the variables.¹⁵ These results yielded partial support for the discrimination hypothesis. The interaction between female labour force participation and schooling is positive and statistically significant, suggesting that there is less of a negative effect of female education on growth in countries that have relatively more women in the labour force. But even for a country with 100% female labour force participation, female education is predicted to have a very small, positive effect on growth that is virtually indistinguishable from no effect.

2.4. Effect of measurement error on initial education level

The positive effect of the initial level of education on growth is often interpreted as evidence of large externalities from the stock of a nation's human capital on economic growth. But Topel (1998) argues that "the magnitude of the effect of education on growth is vastly too large to be interpreted as a causal force." Topel calculates that the present value of a one-percentage-point-faster growth rate from an additional year of schooling would be about four times the cost, with a 5% real discount rate. He concludes that externalities from schooling may exist, but they are unlikely to be so large.

One possibility is that the level of schooling is spuriously reflecting the effect of the change in schooling on growth, which could account

¹⁵ The labour force data are from "Economically Active Population 1950-2010," Bureau of Labour Statistics, International Labour Office, Geneva, 1997.

for its large impact on growth. Countries with higher initial levels of schooling also tended to have larger increases in schooling over the next 10 or 20 years in Barro and Lee's data, which is remarkable given that measurement error in schooling induces a negative covariance between the change and initial level of schooling. We initially suspected that the initial level of schooling spuriously picks up the effect of schooling increases, either because schooling changes are excluded from the growth equation or because the included variable is noisy. In Krueger and Lindahl (1998; section 2.4), however, we show that this is most unlikely. In particular, we show that if education is measured equally reliably each period, and if first- and second-period education are included in the growth regression, then the sum of the two coefficients on the education variables will be biased toward zero. Because a test of whether the initial level of education influences economic growth conditional on the change in education turns on whether the sum of the coefficients on current and lagged education is positive, measurement error in education would tend to produce a bias against finding that the initial level of education influences growth.

2.5. Controlling for physical capital

The initial capital level and capital growth rate are natural control variables to include in the GDP growth regressions. First, initial log GDP can be substituted for capital in a Solow growth model only if capital's share is constant over time and across countries (e.g., a Cobb-Douglas production function). Second, and more importantly for our purposes, capital-skill complementarity would imply that some of the increased output attributed to higher education in Table 4 should be attributed to increased capital (see, e.g., Goldin and Katz, 1997). But as mentioned earlier, systematic correlation between measurement errors in capital and GDP, and endogeneity of capital, are reasons to be wary about including the capital growth in a GDP equation. Nonetheless, here we examine the robustness of our results to controlling for physical capital.

Column 1 of Table 5 reports an estimate of the same 20-year growth model as in column 9 of Table 4, augmented to include the growth of capital per worker. We use Klenow and Rodriguez-Clare's (1997) capital data because they appear to have more signal than

Benhabib and Spiegel's capital data.¹⁶ The coefficient on the change in education falls by more than 50% when capital growth is included, although it remains barely statistically significant at the .10 level. In column 2, we add the initial log capital per worker, and in column 3 exclude the initial log GDP from the column 2 specification. Including initial log capital drives the coefficient on the change in schooling to close to zero. Notice also that the log of initial capital per worker has little effect in column 3.¹⁷ The growth of capital per worker has an enormous effect on GDP growth, greatly exceeding capital's share in most countries. This finding is consistent with the errors in capital being systematically related to GDP, because both are functions of investment. To explore the sensitivity of the results, in column 4 we constrain the coefficient on the growth in capital to equal 0.35, which is on the high end of the distribution of non-labour's share around the world. These results indicate that the change and initial level of schooling are associated with economic growth. Moreover, as Heckman and Klenow (1997) find in cross-sectional data, the coefficient on the change in education is similar to microeconomic estimates.

As mentioned earlier, including capital could exacerbate the measurement error in schooling. We find that the reliability of Barro-Lee's 20-year change in schooling data falls from .58 to .46 once we condition on the change in capital, suggesting that the coefficient on the change in schooling in Table 5 should be roughly doubled. In column 5, to try to overcome measurement error we estimate the growth equation by instrumental variables, using Kyriacou's schooling data as excluded instruments for the change and level of schooling. This is the same estimation strategy previously used by Pritchett (1997), but we employ different schooling data as instruments and use a different measure of capital. Unfortunately, because there is so little signal in education conditional on capital, the IV results yield a huge standard error (.167) for the effect of the change in education. Pritchett simi-

¹⁶ A regression of Benhabib and Spiegel's change in log capital on the corresponding variable from Klenow and Rodriguez-Clare yields a regression coefficient (and standard error) of .95 (.065). The reverse regression yields a coefficient of .69 (.05). These estimates could be biased toward one due to correlated measurement errors in the two variables, because both depend on investment.

¹⁷ If the change in log capital per work is dropped from the model in column (3), then initial log capital per worker has a statistically significant, negative effect and the schooling coefficients are similar to those in column 9 of Table 4.

larly finds a large standard errors from his IV estimates, although his point estimates are negative.¹⁸

Table 5. The effect of schooling and capital on economic growth, dependent variable: annualised change in log GDP per capita, 1965-85.

	OLS			IV	
	(1)	(2)	(3)	(4)	(5)
ΔS	.066 (.039)	.017 (.032)	.015 (.042)	.083 (.043)	.069 (.167)
S_{65}	.004 (.001)	.0013 (.0008)	.0005 (.0010)	.002 (.001)	-.001 (.002)
Log Y_{65}	-.009 (.003)	-.026 (.003)	--	--	--
Δ Log capital per worker	.598 (.062)	.795 (.058)	.648 (.073)	.35*	.597 (.119)
Log capital per worker 1960	--	.016 (.002)	.002 (.002)	-.002 (.002)	.001 (.004)
R^2	.63	.76	.58	.12	.55
Sample size	92	92	92	92	66

Notes: Change variables were divided by the number of years spanned by the change (20 years for schooling and log GDP, 25 years for capital). Schooling data used in the regressions are from Barro and Lee. The instrumental variables model in column 5 uses Kyriacou's schooling data as excluded instruments for the level and change in Barro-Lee's schooling variables. Capital data are from Klenow and Rodriguez-Clare (1997), and pertain to 1960-85. *The coefficient on the change in log capital in column 4 is constrained to equal .35, which is roughly capital's share.

One final point on these estimates is that, to be comparable to the Mincerian return to schooling, the coefficient on the change in education should be scaled up by a factor equal to one over labour's share if the aggregate production function is Cobb-Douglas and human capital is an exponential function of schooling.¹⁹ This would raise the cross-country estimate of the benefit of schooling increases even further.

We draw four main lessons from this investigation of the role of capital. First, the change in capital has an enormous effect in a GDP

¹⁸ Aside from the different data sources, the difference between our IV results and Pritchett's appears to result from his use of log-schooling changes. If we use log-schooling changes, we also find negative point estimates.

¹⁹ We are grateful to Kjetil Storesletten for pointing this out to us.

growth equation, probably because of a mechanical relationship between the errors in measuring capital and GDP or because of reverse causality. Second, the impact of the level and change in schooling on economic growth is sensitive to whether the change in capital is included in the growth equation and allowed to have a coefficient that greatly exceeds capital's share. Third, controlling for capital exacerbates measurement-error problems in schooling. Instrumental variables estimates designed to correct for measurement error in schooling yield such a large standard error on the change in schooling that the results are consistent with schooling changes having no effect on growth or a large effect on growth; in other words, these results are uninformative. Fourth, when the coefficient on capital growth is constrained to equal a plausible value, changes in years of schooling are positively related to economic growth. Unless measurement error problems in schooling and capital can be overcome, we do not think the cross-country growth equations that control for capital growth will be very informative insofar as the benefit of education is concerned.

In all, we think the results in this section fairly consistently point to an association between GDP growth and contemporaneous education changes, once measurement error in education is accounted for. Although this relationship could come about for spurious reasons (e.g., fast-growing countries could choose to spend more of their resources on education), the growth equations do not reject a traditional role for human capital.

3. Robustness of the initial level of education effect on growth

[I]t is not possible to draw a simple straight line relating secondary education to economic growth.

—W. Arthur Lewis, 1964

The macro growth equations impose the restriction that all countries have the same relationship between growth and initial education, and that the relationship is linear. The first assumption is particularly worrisome because the micro evidence clearly indicates that the return to schooling varies considerably across countries, and even across regions within countries. For example, institutional factors that compress the wage structure in some countries result in lower returns to schooling in those countries (see, e.g., the essays in Freeman and

Katz, 1995). If the private return to education varies across countries, externalities from the stock of education may vary as well. Thus, we first allow the effect of the level of education on growth to vary by country. Next, we examine the effect of relaxing the linearity assumption and controlling for additional variables. Both of these extensions to the standard growth specification suggest that the constrained specification estimated in the literature should be viewed with caution.

3.1. Heterogeneous country-education effects

The specifications previously estimated in the empirical growth literature constrain the initial level of education to have the same effect in each country. A more general model would allow the initial level of education to have a different effect in different countries. Because there is more than one observation per country in the 5- and 10-year growth models, this easily can be accomplished by interacting a set of dummy variables that indicate each country with the base year level of education for those countries. The average of the country-specific-education slopes provides an informative measure of the effect of initial education on growth for the average country. It is instructive to note that the coefficient on initial education estimated from the restricted, single-coefficient OLS model can be decomposed as a weighted average of the more general country-specific slopes, where the weights are the country-specific contributions to the overall variance in schooling.²⁰ This result is important because it indicates that the source of variation in the single-coefficient regression and average of the variable coefficients model is the same, but the country-specific slopes are aggregated differently in the two estimates.

If the assumptions of the constant-coefficient model hold (and the other Gauss-Markov assumptions hold), the OLS weights are the most efficient weights. But if a variable-coefficient model is more

²⁰ This result requires that there are no other covariates; see Krueger and Lindahl, 1998. If country-fixed effects are included in the model, the OLS constant coefficient can still be decomposed as a weighted average of the country-specific coefficients even if there are other covariates. But we exclude country-fixed effects so that these estimates are comparable to the earlier ones and because including fixed effects would exacerbate measurement error bias. We would also point out that the average of the country-specific coefficients is still informative when there are covariates, even if the single coefficient estimate cannot be decomposed as a simple weighted average of the country-specific coefficients.

appropriate, there is no a priori reason to prefer the OLS weights over other weights. Indeed, it is rather odd to weight the country-specific slopes by the OLS weights if the slopes differ across countries. The unweighted-average coefficient is probably a more relevant summary statistic because it represents the expected value of the education coefficient for a random country in the world.

In Krueger and Lindahl (1998; Table 6), we estimated variable-coefficient models using 5-year and 10-year changes in GDP; we summarise the results here. First, consider results of relaxing the homogenous-education-coefficient assumption in the models in columns 1 and 5 of Table 4. The constant education slope assumption is overwhelmingly rejected by the data for each time period (p -value < 0.0001). The R^2 of the equations more than doubles when the education slopes are unconstrained. Of more consequence, the average slope coefficient on the initial level of education is negative, though not statistically significant, in the variable-coefficient models (see Krueger and Lindahl, 1998; Table 6). These results cast doubt on the interpretation of initial education in the constrained macro growth equation common in the literature.

We also estimated variable-coefficient models using the average years of secondary and higher schooling for males instead of the average years of all education for the adult population. This variable has been emphasised as a key economic-growth determinant in Barro's work. But again, the results of the constant-coefficient model are qualitatively different than those of the variable-coefficient model. For the average country in the sample, a greater initial level of secondary and higher education has a statistically significant, negative association with economic growth over the ensuing 10 years.²¹

3.2. Exploring the linearity assumption and additional explanatory variables

It is common in the empirical growth literature to assume that initial education has a linear effect on subsequent GDP growth. Although Mincer (1974) provides conditions under which education has a linear

²¹ Casselli, Esquivel and Lefort (1996, Table 4) also find that the coefficient on male secondary and higher education has a negative effect on growth when they use a generalised method of moments model to estimate a first-differenced specification of the growth equation. Note that our random coefficient approach uses the same cross-section variation in education to identify the coefficient on education as our OLS results in Table 4.

relationship with log earnings, these conditions do not necessarily imply that the initial level of education has a linear relationship with income growth. To examine the linearity assumption, we included initial education and its square in the 10-year change model in column 4 of Table 4. Column 1 of Table 6 reports these results. The data seem to prefer the quadratic specification, as the squared education term is statistically significant. More importantly, the relationship is inverted U-shaped, with a peak at 7.5 years of education. Because the mean level of education for OECD countries in 1990 was 8.4 years in Barro and Lee's data, the average OECD country is on the downward-sloping segment of the education-growth profile. If we also include the square of log GDP per capita, the initial level of education continues to have a non-linear effect that peaks below the average level of education of OECD countries; see column 2. We also find an inverted U-shaped relationship between education and GDP growth that peaks below the level of education of developed countries when we examine 5- and 20-year changes in GDP.

The results in columns 3 and 4 of Table 6 indicate that the effect of the initial level of education is sensitive to including other covariates in the model. These models hold constant several additional explanatory variables that are often controlled for in the literature, including the log of the fertility rate, log life expectancy, and investment and government spending as shares of GDP.²² Although one could question whether these variables are appropriate exogenous regressors to include in a growth equation, the significance of the initial level of education in either the linear and quadratic specification is greatly diminished when these variables are controlled for. The initial level of schooling becomes statistically insignificant if just the fertility rate log is included in the equation. Average years of secondary and higher schooling solely for men has a more robust association with economic growth than the broader education measure used in Table 6—if it is included in the growth equation instead of the average level of schooling of the entire population. But, as we discussed previously, we believe there are strong reasons for preferring the broader measure of education.

²² These data were derived from <http://www.nber.org/pub/barro.lee>.

Table 6. Analysis of impact of controlling for additional explanatory variables and quadratic specification on initial schooling effect. Dependent variable: annualised 10-year change in log GDP per capita.

Explanatory variable	(1)	(2)	(3)	(4)
Initial schooling	.010 (.002)	.010 (.002)	.002 (.002)	.000 (.001)
Initial schooling squared	-.0007 (.0002)	-.0007 (.0002)	-.0002 (.0001)	--
Initial Log GDP	-.005 (.003)	-.005 (.022)	.030 (.025)	.035 (.025)
Initial Log GDP squared divided by 100		.003 (.146)	-.303 (.163)	-.338 (.162)
Log fertility rate			-.025 (.005)	-.025 (.005)
Log life expectancy			.008 (.016)	.013 (.015)
Terms of trade			.105 (.040)	.104 (.044)
Democracy index			.001 (.002)	.002 (.002)
Democracy Index Squared (/10,000)			-.076 (.039)	-.083 (.038)
Investment relative to GDP			.0008 (.0002)	.0008 (.0002)
Government consumption relative to GDP			-.080 (.031)	-.080 (.031)
Inflation rate			-.026 (.005)	-.026 (.004)
R ²	.284	.284	.527	.526
Peak of schooling quadratic	7.46	7.57	5.80	--
P-value for F-test of schooling terms	.000	.000	.582	--

Notes: Sample size is 292 for all columns. Observations with missing values of some variables were assigned the mean value for those variables. Schooling and GDP per capita are initial values (i.e., values at the start of the 10-year period.) The inflation rate is measured from the start to the end of the 10-year period. The terms-of-trade variable is the growth rate over each period of the ratio of export to import prices. All other variables are averages over the 10-year periods.

3.3. Estimates for OECD countries

In view of the sensitivity of the effect of the initial level of education on economic growth to the econometric assumptions previously discussed, it is worth exploring whether the results hold for the sample of OECD countries. Table 7 presents estimates of the effect of initial education on growth for the subset of OECD countries, measuring GDP growth over 5-, 10- or 20-year periods. In each case, the initial level of education had a statistically insignificant and small effect on economic growth. We similarly find that the initial level of secondary and higher education for men has a statistically insignificant effect if it is included in the growth equation for OECD countries instead of the broader schooling measure. These results are not surprising in light of the earlier finding that the average OECD country is on the downward-sloping segment of the education-growth curve estimated in Table 6.

Table 7. The effect of schooling on economic growth in the OECD. Dependent variable: annualised change in log GDP per capita, various time periods.

	5-year growth	10-year growth	20-year growth
Variable	(1)	(2)	(3)
Initial schooling	-.000 (.001)	-.000 (.001)	.000 (.001)
Initial log GDP	-.015 (.008)	-.015 (.006)	-.011 (.005)
R ²	.43	.55	.35
Sample size	138	69	23

Notes: The dependent variable was divided by the number of years spanned by the change. Columns 1 and 2 also include time dummies.

Together, the results in this section cast doubt on the likelihood that there are large growth externalities from the initial level of education. The pattern of results in the less restrictive (i.e., non-linear and variable coefficient) specifications, and models with more extensive covariates, cast doubt on the view that the initial level of education exerts a strong influence on growth, especially in high education countries. Most notably, the initial level of education seems unrelated to subsequent growth in OECD countries even in the parsimonious linear model.

4. Conclusion and policy implications

And the preservation of the means of knowledge, among the lowest ranks, is of more importance to the public, than all the property of the rich men in the country. It is even of more consequence to the rich themselves, and to their posterity.

—John Q. Adams, 1765

Both the micro and macro literatures emphasise the role of education for raising income, and income growth. An accumulation of research using individual-level education and income data since the beginning of the 20th century provides robust evidence of a substantial payoff to investment in education, especially for those who traditionally complete low levels of schooling. From the micro evidence, it is unclear whether the social return to schooling exceeds the private return, although available US evidence suggests that positive externalities in the form of reduced crime and reduced welfare participation are more likely reaped from investments in disadvantaged than advantaged groups. The macroeconomic evidence of externalities in terms of technological progress from investments in higher education seems to us to be more fragile. Externalities from the initial human-capital stock appear particularly unlikely to apply to OECD countries.

Our findings help resolve an important inconsistency between the micro and macro literatures on education: Contrary to Benhabib and Spiegel's (1994) and Barro and Sala-i-Martin's (1995) conclusions, the cross-country regressions indicate that the change in education is positively associated with economic growth once measurement error in education is accounted for. Griliches (1997) conjectured that the "jarring" finding of no relationship between education changes and GDP growth was due to either measurement error in education or a tendency for more highly educated workers to enter sectors of the economy whose contribution to GDP are systematically under measured. Measurement error in education appears sufficient to account for the insignificant effect of education changes. After adjusting for measurement error, the change in average years of schooling often has a greater effect in the cross-country regressions than in the within-country micro regressions. Controlling for capital growth reduces the effect of education changes, but the magnitude of the effect in the cross-country data is still at least as great as the micro return to education once measurement error is taken into account.

The large return to schooling changes found in the cross-country models suggests that reverse causality or omitted variables create problems at the country level of analysis, or that increases in average educational attainment generate nation-wide externalities. Although the microeconomic evidence in several countries suggests that within countries the causal effect of education on earnings can be estimated reasonably well by taking education as exogenous, it does not follow that cross-country differences in education can be taken as a cause of income as opposed to a result of current income or anticipated income growth. Moreover, countries that improve their education systems are likely to concurrently change other policies that enhance growth, producing a different source of omitted-variable bias in cross-country analyses. Education, in the eloquent description of Harbison and Myers (1965), “is both the seed and the flower of economic development.” It is difficult to separate the causal effect of education from the positive income demand for education in cross-country data. For this reason, Mankiw (1997) describes the presumed exogeneity of school enrolment as the “weak link” in the empirical growth literature. In our opinion, this link is unlikely to be strengthened unless:

- The cross-country literature can identify natural experiments in schooling attainment similar to those that have been exploited in the microeconomic literature
- Measurement errors in the cross-country data are explicitly accounted for in the econometric modelling.

For policy-makers, the obvious prescription to enhance growth is that, on the margin, funds should be invested in the components of the education system that generate the highest social returns. But the micro and macro evidence suggest that the returns to investing in different levels of education are likely to differ across countries, depending on the country’s state of development, distribution of income, and structure of the education system. There are unlikely to be universal answers. In the US, there is much support for the view that investments in young, disadvantaged children have the highest returns and that it is very difficult to improve the economic circumstances of adolescent high school dropouts with short-term job training (e.g., Heckman, 1998). This view implicitly underlies the recent increased support for Head Start and smaller primary school

classes, and the shift in JTPA funds away from job training for out-of-school youth. But the circumstances in the US may be unique.

Optimal education policy for Sweden may be quite different than for the US. Heckman (1998) argues that investment in very young children in the US pays a high return because "early learning begets later learning." In the US, 22% of the children under age 6 live in families that fall below the poverty line, and an incredible 59% of the children under age 6, who live with single mothers, are in poverty (US Census Bureau, 1998). High rates of childhood poverty, coupled with a patchwork system of child-care arrangements, may lead to particularly high payoffs to investments in young children in the US. Moreover, the lagging development of many children in the US, and high existing subsidies to colleges (see Winston and Yen, 1995), may reduce the return on investments at older ages. Sweden has a much more equal distribution of income and a more extensive and universal system of child-care. Consequently, Sweden may be in a situation where investments in education for older students pay a higher return than investments in programs for very young children. But one must also be concerned that the US evidence, *vis-à-vis* age, may reflect the fact that there are critical stages of development during childhood that condition the payoff to investments at various ages, and that these stages largely determine the payoff to investing in certain age groups irrespective of economic and social circumstances.

Another overriding factor in Sweden involves the compression of the wage structure, which depresses the private return to acquiring skills—compared to the US and most countries of the world. Edin and Holmlund (1995) and Fredriksson (1997) find that college enrolment in Sweden is quite responsive to the private payoff to education prevailing at the time that students make their enrolment decisions. Although Sweden has a high level of post-secondary educational attainment by world standards, it is nonetheless likely that the education-attainment level is distorted by the depressed private payoff to education and skills. This consideration may militate in favour of a policy of increasing education at higher levels in Sweden. But how this is best accomplished is unclear. The current thrust of subsidising dislocated workers to return to school has benefits and costs. For example, older workers will enter the work force more quickly than, say, pre-school children, so the gestation period for investments in older workers' human capital is much shorter. However, the US experience has been one of rather ordinary returns to invest-

ments in education for dislocated workers. Moreover, in Sweden some observers are concerned that subsidising unemployed workers to return to school may create a disincentive in which some workers intentionally delay completing their education, find a job only to become unemployed, and then spend a long period in school while collecting unemployment insurance benefits.

We recognise that our conclusion leaves policy-makers in something of a quandary. On the margin, should they attempt to expand education for the least or most able, youngest or oldest, to enhance growth? While the macro growth literature may lead policy-makers to try to expand higher education, and the US micro-level research on education and training may support a policy of investments in disadvantaged, pre-school children, we think a prudent approach for a country such as Sweden would be to pursue a diverse strategy of raising human capital on several fronts.

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