

Investing in people

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Is the Canadian economy investing enough in people and their skills? Perhaps not, according to recent evidence - and failing to do so will hurt Canadians' long-run living standards.

Canada is usually seen as having a good education system and should therefore be expected to do well at building "human capital." However, the International Adult Literacy Survey (IALS) shows that Canada does not perform well on standardized tests of literacy and numeracy. According to the IALS, Canada ranks in the middle of the pack on the prose-writing, document comprehension and quantitative literacy scales.

Worse, many of the countries that scored at the low end of the scale are significantly less developed economically than is Canada; our rank appears even poorer when compared with countries at a similar level of development. Perhaps more worrisome is that if we look only at individuals who have not completed high school, Canada ranks 13th, 14th and 14th in prose, document and quantitative skills.

Much of the policy debate today focuses on the role of post-secondary education in providing highly skilled workers for the knowledge economy as a means of ensuring international competitiveness. More basic education has been neglected. One reason could be that economists have had difficulty establishing a strong empirical link between educational attainment and economic growth at the cross-country level.

However, our recent research shows that if we use such direct measures of skills as the IALS, rather than educational attainment data, we see a clear relationship between investments in human capital and long-run economic growth and labour productivity. This research (The Economist has called it a "breakthrough in measuring the knowledge economy") reminds us of the equal, if not greater, importance of increasing the general level of literacy and numeracy among young people, a job that is mainly the purview of primary and secondary schools. The payoffs come in the form of increased economic growth, which benefits society as a whole.

Specifically, if a country's literacy scores rise by 1 per cent relative to the international average, that may generate an eventual 2.5-per-cent relative increase in labour productivity and a 1.5-per-cent rise in output per person. That's big - three

times as great a result as for investment in physical capital.

Moreover, the results indicate that increasing literacy and numeracy for people at the low end of the skills range is more important to economic growth than producing more highly skilled graduates.

Canada's relatively poor performance in literacy and numeracy should be a serious concern for policy-makers. It would be good to respond to this situation by working out a comprehensive skills strategy, one that would exploit the different channels through we build human capital.

First, because skills, rather than schooling per se, drive economic growth, attention to the school system's output is the place to start. All governments should produce publicly available indicators of student and school performance based on standardized skills tests. The benefits include stronger incentives for education providers to improve outcomes, and increased competition and accountability throughout our school systems.

Second, because people move across provincial borders, provincial governments have less incentive to invest in educating people who may move away. A good way to compensate for this would be to partly allocate federal transfers according to provinces' investments in education.

Third, it's vital to invest in the skills of adults who are already part of the work force. The pace of technological progress creates new skill requirements in the labour market; demographic trends will tend to reduce the relative role of one's initial education to the overall process of accumulating skills. Better incentives for firms and people to pursue job-related training and lifelong learning - particularly measures targeted at people with very low skills - would generate greater economic rewards.

Our work suggests that targeting investment in people at the low end of the skills scale may be especially important. The returns to human capital in the form of higher economic growth are more sensitive to the entire population's average skills as opposed to its share of individuals with high-level of skills. That is, a high proportion of individuals with low levels of literacy acts as a drag on growth.

The right thing to do, therefore, is to ensure that young people acquire basic skills before entering the labour market. Devoting more education resources to increasing graduation rates at the secondary level would be good for economic growth, but increasing the graduation rates should not be done by lowering standards.

One of the most salient results of our research is the finding that skills matter more than years of schooling. Making welfare and employment-insurance programs more

conducive to completing high-school education may also help to increase graduation rates and skills acquisition.

By the same token, it may be desirable to target adult-training programs towards low-skilled individuals, who tend to receive little employer support for training. Increasing resources in government-training programs for the unemployed could also help if workers cannot finance investments in training by themselves.

Finally, immigration policy is an important component of a comprehensive skills strategy. Immigration can be a highly cost-effective approach to skills accumulation, and easily tailored to specific needs. The trick is to focus on skills rather than years of schooling, because schools are not the same everywhere. Attracting more skilled immigrants - and increasing the importance of demonstrated skills in immigrant selection - would help Canada distinguish itself among nations in the 21st century.

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