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When higher education doesn't pay: a Caribbean example

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Superior high schools and universities may be good for individuals, but they don't necessarily make a poor country wealthier. That is one of the surprising lessons to be drawn from a new comparative study of Caribbean and East Asian nations by Stanford economist Donald Harris.

Harris, a specialist in the economic growth of lesser developed countries in this hemisphere, also finds that the trade preferences European nations gave their former West Indian colonies have done more harm than good.

"I call these trade preferences a perverse incentive," he said. "Those are strong words, but I think they are correct in this case."

Upgrading school buildings, roads, and facilities for water, sewage, telephone and electricity doesn't seem to spur long-term economic growth in poor countries, the study also found, if resources are squandered in supporting immediate consumption and lifestyles of the elite rather than on building export growth.

"Education and other infrastructure is all well and good, but you have to have something else, which is investment in export production via diversification into new lines of tradable goods and services," Harris said his comparative data on the Caribbean and Asia indicate.

He found that every dollar of foreign investment in the Western countries he studied produced only 17 cents' worth of export growth, whereas the normal payoff expected is 25 to 50 cents. Internal conditions within those countries retarded their response to changes in global markets, Harris said, and while he is still working on pinning down those internal factors, the data are clear enough that he would advise governments and international aid agencies to change their tactics for spurring growth in countries like Haiti and El Salvador.

"The key question you have to ask now is how to get the middle class to come back home or to keep them from fleeing to Miami in the first place."

Southern Florida grew rapidly in the '70s and '80s from the influx of migrants from El Salvador, Cuba, Jamaica, Venezuela and Colombia. "These are all countries that had great political instability in the '60s and '70s, and as a result, they lost some of their entrepreneurial class. I think aid programs need to be longer than two years and designed to provide a dependable economic and political base over the next three, four or five years in order to lengthen the investment horizon of domestic entrepreneurs," Harris said.

Many migrants, he points out, have been the "better educated people and the more savvy in terms of how international markets and finance work. That is why today you have some of the most sophisticated financial firms in the city of Miami mostly run by Latins who came from those countries."

While their presence is a plus for the U.S. economy, he said, it represents a minus for their home countries, as well as a negative for regional political stability.

"You don't want the entrepreneurial class leaving or earn-

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ing quick bucks [at home] from taking advantage of consumer shortages the way the military people have done in Haiti," he said. "You want them to make investments with a longer term payoff for their country."

Asian "tiger" comparison

Harris' conclusions are the preliminary results of his ongoing efforts to answer the flip side of a more common question asked by development economists: What accounts for the phenomenal economic success of the East Asian "tigers" – Taiwan, Hong Kong, South Korea and Singapore? He asks instead why similar nations in the Caribbean fell behind the tigers and even behind the lesser developed countries of Thailand and Indonesia on a per capita income growth basis.

Harris compared 25 years of economic data on the Caribbean nations of Barbados, Jamaica, the Dominican Republic, and Trinidad and Tobago and the central American nation of Costa Rica with data from their East Asian counterparts. He found, to his surprise, that the Caribbean nations and Costa Rica had assembled superior social and physical infrastructures to the East Asian countries as early as 1965.

"They had better developed educational and health systems, a more literate population, as well as better communication and transportation networks. The term used for their condition in those days was that they were 'poised for takeoff,' " he said. But the anticipated flight of these countries was aborted in the late '70s.

The airplane metaphor is based on the economic theory and research of Walter Rostow and other development economists of the '50s and '60s who discovered that the already economically advanced countries experienced rapid growth just after they developed a critical mass of social and physical infrastructure. Such research guided foreign aid and de-colonizing policy decisions of that era.

'The key question you have to ask now is how to get the middle class to come back home or to keep them from fleeing to Miami in the first place'

"In the Caribbean in the 1960s, we had a primary education system that was nearly universal, but the school system was even more well developed at the secondary level and produced a highly educated elite," Harris said. "The top students went on to Oxford and Cambridge and the best universities in the United States," whereas the East Asian countries lagged behind in producing students with college credentials.

Caribbean graduates of foreign universities became very successful in academia and in the professions, he said. "Some of the best doctors and dentists in Washington, D.C., for example, are Caribbean people." In contrast, the East Asian tigers invested in a primary education system that emphasized basic reading, writing and arithmetic for all, with a special emphasis on arithmetic.

"We now know from studies of Asia that this school organization was a very important component of their infrastructure. What is important about the Caribbean study is that it shows the payoff from university education is not as high from the standpoint of general economic development as the payoff from primary and secondary education."

But how does that fit with other studies that show college degrees yield higher incomes for graduates?

"If you or I get a master's or a Ph.D. degree, we are clearly upping our income potential," Harris said, "but from society's point of view, from the standpoint of social productivity, the more effective route is to have good, universal primary education first and foremost and then beef up the secondary school level with skills that will allow people to adapt to modern technology.

"You also have to have something else, which is the investment in expanding exports via diversification into new lines of tradable products or services. That is what creates the demand for the newly acquired skills."

In other words, Harris said, it matters a great deal whether the water and electricity produced from a new dam are used to build a new strip of downtown stores and better homes for the masses or elites, or whether they allow farms, factories and tourist facilities to produce an ever increasing array of products and services to be marketed to those who live outside the country. "Once a home is built, the employment benefit of that expenditure is gone," Harris said.

Agricultural diversification

A second unconventional finding from Harris' work is that getting farmers to innovate can be as important to an underdeveloped country as getting new factories opened. He found, for example, that Costa Rica is well ahead of the other "banana republics" he studied because its farmers innovated, producing such high value-added products as banana chips and frozen fruit sticks for the European market.

"Costa Rica moved very quickly into agricultural processing, such as processed fruits, canned meat products and cut flowers. These are typically higher wage, higher productivity agricultural sectors, and today Costa Rica is much better off."

In retrospect, he said, "you can see this lesson earlier in the history of some of the European countries. Denmark and Holland were predominantly agricultural, and that [diversification in agriculture] is the strategy they used to grow."

Diversification was greatly undermined in the Caribbean, Harris now believes, by special trade preferences that were given to products from the former colonies of Western Europe when they became independent. Later, President Reagan compounded the problem with his Caribbean Basin Initiative, which gave these countries more breaks from tariffs and quo-

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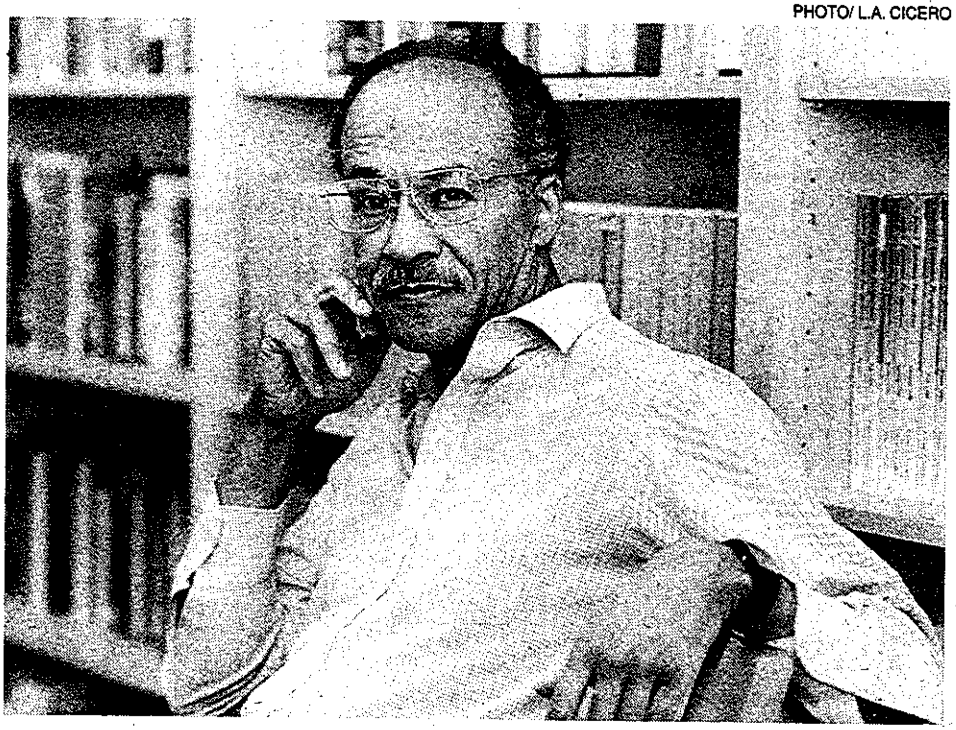

'Getting farmers to innovate can be as important to an underdeveloped country as getting new factories opened'

Donald Harris, professor of economics, is a specialist in the economic growth of lesser-developed countries in this hemisphere. He has found that the trade preferences European nations gave their former West Indian colonies have done more harm than good.

tas on manufactured goods produced in special "export processing zones."

These perceived favors, Harris says, may have been a major reason the Caribbean nations "got stuck" economically and fell behind other developing nations in the late '70s and '80s when the whole world fell prey to price shocks.

Trade preferences in Europe for bananas, he explains, are not unlike the price supports American dairy farmers receive from their own government. They make it rational for the farmers to keep producing the same products, even though the price consumers are willing to pay is declining.

"The American, French or Caribbean farmer who has a guaranteed price has a reduced incentive to do exactly what the Asians did, which is to look around for opportunities to diversify to new lines of production with greater value added, and with greater technological spillovers and potential for productivity growth," Harris said.

The result for the Caribbean nations that produce bananas has been reduced market share, he said. "Ecuador and Costa Rica, countries which don't have quota preferences, have to compete on the open market, and what you find is that their productivity is much higher. They have innovated and developed the kinds of fruit products that are attractive to European buyers. For that reason, they have managed to increase their market share."

The situation with banana farmers, Harris said, is what economists call a "lock-in effect," and a similar disincentive to innovate hurts Caribbean manufacturing growth in its export processing zones. The general problem of lock-in, he explained, is not one of failure from the individual firm's standpoint but one of too much success.

Lock-in effects

"The idea of a lock-in effect is that a group of firms in a certain line of technology will develop an infrastructure of knowledge which allows them to become good at searching for new ways of doing things within their expertise," Harris said. "Because they are so successful at what they do, they are blinded to other possibilities out there. Whether you become locked in because you've had a good run of technology or because you benefit from some sort of preference isn't relevant. The point is that you get locked into what you do and that inhibits you. You develop a kind of inertia. This inertia is the cause of the Caribbean countries being behind the Asians."

Another irony of the situation, he said, is that it is now textile manufacturers from the southern United States and the East Asian tigers who are taking advantage of the Caribbean's special export zone privileges with the United States.

"I was intrigued by this at first, but when you think about it globally, it makes a lot of sense," he said.

"You and I used to buy cheap clothes that came from Taiwan and South Korea. There was a stigma attached to them. But these countries have learned from their experience and upgraded their skills.

"Now, if you want a good, tailored suit, you go to those Asian countries, and in turn, they are re-locating some of their lesser skilled assembly in the Caribbean because they have run up against their quota limits for imports to the United States."

Harris doesn't think this is necessarily bad for the Caribbean. What is important to the Caribbean people, he said, is that the foreign companies operating there feel some pressure to introduce "medium-tech" skills so that workers can move beyond assembly to computer-aided cutting and design of clothing.

Companies would feel more pressure to upgrade workers' skills, he said, if the Caribbean countries abandoned their special export zones and allowed every firm operating within a country to compete for the export quota preferences the country has in the United States.

Harris also sees hope for the Caribbean through more growth in its successful tourism industry. The region's health infrastructure, including well-trained nurses and other health care workers, "was developed to solve the basic health needs of the population," he said, "but it inadvertently turns out to be a launching pad for further diversification in export growth now."

Because the United States and Europe face high and rising health care costs, he said, the Caribbean in general, and Cuba in particular, are now "well positioned" to offer cheaper routine surgery and health care to aging Americans and Europeans.

"Northern Mexico is already having a big success with health tourism," he said, "but the Caribbean is even in a better position. They have more sea and sand." ■