

## Concept

# Human Capital

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### Definition

Human capital is "the knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being." The definition recognizes both natural qualities (age, gender, and health) and learned abilities (education and training) that can be translated into wellbeing.<sup>1</sup>

### Context

In the context of strategic socio-economic policy planning, human capital relates to the following issues:

- **Growth** – Developed economies without natural resource wealth base their continued growth on the quality and improvement of their human capital.<sup>2</sup>
- **National Competitiveness** – Productivity growth, the basis of national competitiveness, depends on the quality and relevancy of a country's human capital in the global marketplace.
- **Quality of Life** – An individual's quality of life is influenced by material wellbeing and employment security.<sup>3</sup> An individual's ability to guarantee wellbeing hinges on the demand for his ability and skills in the labor market.
- **Poverty** – A clear correlation between poverty and lack of education has been found in Israel and the world.<sup>4</sup> Those with education manage to improve their situation in tandem with economic growth, while those without education experience relative decline.

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<sup>1</sup> Definition taken from OECD, [The Well-being of Nations: The Role of Human and Social Capital](#), 2001. The concept was originally mentioned by Pigou and further developed by Becker and Shultz to describe the economic value of individual skills and abilities. The OECD definition, which addresses a broader concept of personal abilities and wellbeing is more relevant to strategic policy planning. For more on the discussion surrounding the term see:  
Becker, GS. **Human capital**. New York: Columbia University Press, 1964.  
Shultz, T. **The Economic Value of Education**, New York: Columbia University Press, 1963.  
Pigou, A. **A Study in Public Finance**, Macmillan: London, 1928. p. 29

<sup>2</sup> For more on the importance of human capital for Israel's growth, see: The National Council on Economy, [A Socio-Economic Agenda for Israel 2008-2010](#) (2007); Dan Ben-David, [Wake Up Call: A Work Plan for a New Era in Israel](#) (2005).

<sup>3</sup> According to the Economist Intelligence Unit's [Quality of Life](#) Index, material wellbeing and employment security are two of the nine variables that offer a clear explanation of the differences in quality of life across countries.

<sup>4</sup> Roni Frish, [The Causal Effect of Education on Earnings in Israel](#), Bank of Israel, February 2007 (Hebrew Only).  
A. B. Krueger and M. Lindahl, [Education and Growth: Why and for Whom?](#) **Journal of Economic Literature**, Vol. XXXIX (December 2001) pp. 1101-1136.

- **Economic Fortitude** – Human capital, realized in the labor market, contributes to an individual's ability to live in comfort, to improve wellbeing, and to cope with unexpected changes in personal, family, or employment situations.

## Gauging the Value of Human Capital

An individual's wellbeing is affected by the quality of the human capital he can supply and by the demand for his human capital in the labor market.

The human capital supplied by the individual is affected by:

- **Personal traits** – The ability to translate human capital into wellbeing is affected by quality of education, distance from the job market, age, gender, and family commitments.<sup>5</sup>
- **Participation** – The value of human capital depends on the individual's will and ambition to use and develop it through the job market.
- **Changes over time** – Human capital can be improved through investment in education and training. Likewise, human capital can atrophy with age, health problems, or disuse.

Demand<sup>6</sup> for human capital is affected by:

- **Local economy** – Certain key functions, including the public sector and local service delivery, are persistent elements of the labor market. Demand for workers is affected by its size and productivity.
- **Global competition** – The industrial composition of the economy, and the demand for human capital, is affected by the economy's comparative advantages.<sup>7</sup>
- **Government policy** – Government subsidies, trade policy, regulation and taxation create incentives and disincentives for employment in various sectors.

## Measurement

An individual's ability to translate their human capital into wellbeing is affected by difficult to measure concepts like personality and social connections. Most research confines itself to indicators

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<sup>5</sup> For additional segmentations that are relevant to the Israeli situation, see: [Social-Economic Development: An Illustrated Overview](#), The Taub Center for Social Policy Studies in Israel (2006).

<sup>6</sup> A tacit assumption is that demand is based on merit alone. Most economies lie on a spectrum between pure meritocracy and nepotism. The contributions of an individual's 'political connections' and 'abilities' vary with the rules of the particular economy.

Transparency International's [Global Corruption Report 2007](#).

<sup>7</sup> Israel's integration into the global market has increased the demand for skilled workers and depressed demand for unskilled workers. The Bank of Israel records the changing contribution of various sectors of the Israeli Economy to GDP and employment growth over time.

Bank of Israel Annual Report – 2006, [Chapter 5: The Labor Market](#), Table 5.8, p. 221.

that measure the **quantity**<sup>8</sup>, **quality**<sup>9</sup>, and **relevance**<sup>10</sup> of education. Data is available at all major national and international statistical databases.<sup>11</sup>

End.

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- <sup>8</sup> Quantity measures include: years of schooling, literacy rates, school enrolment rates, and drop-out rates  
Stroombergen, A. *et. al.* [Review of the Statistical Measurement of Human Capital](#), **Statistics New Zealand**, 2002.  
The OECD reviews the important literature on human capital and finds that in most cases, education is used as a proxy for human capital. See: OECD, [The Well-being of Nations: The Role of Human and Social Capital](#), Appendix D, 2001.
- <sup>9</sup> *Ibid.* Quality measures include: pupil/teacher ratios, class size, teacher salary, per pupil funding, length of school year, teacher qualifications, and test scores
- <sup>10</sup> *Ibid.* Relevancy measures include: type of most recent schooling and earnings
- <sup>11</sup> For information on the EU, see [Eurostat](#). On the OECD nations, see the [OECD's Statistics Portal](#). For Israel, see the [Israeli Central Bureau of Statistics](#).