by Monique Jérôme-Forget

Investing in Human Capital

Human capital is now a leading public policy theme in OECD countries. It is held up as the way to reduce unemployment and income inequality, or to improve productivity and economic growth.

The concept is not new. When Robert Reich wrote, in his famous "Who is Us?" 1990 *Harvard Business Review* article that "a nation's most important competitive asset becomes the skills and cumulative learning of its work force," he was merely popularizing something economists have appreciated since Adam Smith. Modern human capital theory traces its origins to the 1960s and the work of Theodore Schultz, Jacob Mincer and Nobel laureate Gary Becker and their theoretical and empirical work on the relationship between human capital investments, *i.e.*, education, and earnings.

More recently, two bodies of research of note have intensified interest in human capital. First, in the "new growth" theories associated with Romer, Barro and Lucas, human capital is key determinant of economic growth. Second, there is a growing interdisciplinary consensus on the critical importance of the first few years of childhood to the formation of intelligent, well-adjusted adults, *a.k.a.*, human capital.

It has become fashionable to trot out human capital investment as the response to three of the most thorny issues facing policy makers in the last several decades — the slowdown of economic growth in most western economies from 1973, the upward trend in unemployment, and the polarization of incomes.

A concept that raises such high hopes risks leaving many disappointed. Although there is certainly some sound evidence for these prescriptions, at a deeper level one cannot but be overwhelmed by the complexity of the issues involved. As T.J. Alexander points out in his contribution here, the current high expectations for human capital investment will almost certainly be dashed, and new support for human capital wane, if policy priorities are not clearly illuminated by rigorous research and analysis. He also advocates a very broad conceptualization of human capital, to fully encompass the complexity of the relationships that influence human capital formation.

Our 1997 July-August issue of *Policy Options* explores some of the theory and empirical evidence on human capital investment, and the policy imperatives that flow therefrom. It cannot possibly do more than whet the appetite, and provide an appreciation of the kind and variety of research that is required to provide policy makers with a sound basis for action.

The range of issues is vast and exceedingly complex. To make the point, consider some of the major changes that have transformed the family unit in Canada over the last 30 years. Today's families are much smaller, with important consequences for the number and the nature of relationships that children experience growing up. With more and more women in the work force, we have moved from a situation where young children were looked after almost exclusively by their mothers to one where most mothers stop working for only a few months during maternity leave. And more and more children are living in single-parent or reconstituted families. The absence of one partner and the instability of family structures can be expected to have a significant impact on early childhood development.

Given the importance of early childhood influences, these trends in family life have potentially enormous long-term effects on human capital formation. It is not surprising, therefore, that several of the articles in this magazine look at efforts to take corrective measures at an early age, before detrimental patterns are firmly set.

Clearly, human capital policy must extend far beyond formal education: it also spans family policy, social policy, health policy, training policy and industrial policy. Education does, however, remain at the core of human capital formation. Much of the research in the field of human capital has involved gathering and analyzing data, over many years and across different countries or jurisdictions, to discern what is effective in generating desirable educational outcomes. In this magazine, you will find a number of articles that explore what measures might improve educational performance; others look at the connection between education and earnings.

Most of the returns from higher education accrue to the individuals being educated. It is believed, however, that a portion accrues to society, in the form of higher economic growth or other social benefits. This becomes one rationale for public sector financing of education; other rationales for public sector support of human capital investment are discussed by several contributors.

The education-to-work transition and adult training constitutes another major focus of research. Human capital can depreciate, if skills are not maintained through regular use. Given this fact, there are some disquieting trends in Canada's current labour market. Youth unemployment is alarmingly high, with too many recent graduates unable to get that crucial first job. There has been a trend upward in long-term unemployment, and that can be expected to lead to a deterioration of skills and knowledge. There is also a evidence of a significant mismatch between the skills workers possess and those required in the jobs that are available.

A myriad of policy proposals are now being sold on promises of the human capital fruits they will bear in the future. If policy makers are to do the cost-benefit comparisons necessary to determine where best to invest limited public funds, they will need much better data and analysis, the kind of information that is now being generated as more and more researchers bring varied perspectives to focus on the many facets of human capital.