JargonAlert

Human Capital

BY DAVID A. PRICE

Theodore Schultz, a University of Chicago economist, gave a talk on a novel subject at the December 1960 annual meeting of the American Economic Association, of which he was president. His subject was "Investment in Human Capital," a young area of economic inquiry at the time.

"The mere thought of investment in human beings is offensive to some among us," Schultz felt it necessary to acknowledge. "Our values and beliefs inhibit us from looking upon human beings as capital goods, except in slavery, and this we abhor. … And for man to look upon himself as a capital good, even if it did not impair his freedom, may seem to debase him."

Today, the term "human capital" is far more widely accepted. The concept of human capital — a person's stock of knowledge and skills, including soft skills, that are valued in the labor market — has become central to the thinking of economists and policymakers on education, labor markets, productivity, and economic growth. Economists treat people as forward-looking investors in their own human capital, adding to it through schooling, training, or work experience if their expected rate of return on the additional human capital is sufficient.

Harvard University economist Claudia Goldin has called the 20th century the human capital century — a reference to the widespread increase in schooling during that period. The "high school movement" in the United States early in the century boosted the share of people entering and finishing high school from less than 10 percent in 1910 to around 50 percent in 1940; high school graduation rates reached approximately 70 percent by the end of the century (over 80 percent counting GED recipients).

College education has also risen significantly in recent decades. According to a 2016 paper by Camille Ryan and Kurt Bauman of the U.S. Census Bureau, a little more than 15 percent of Americans aged 25 to 29 had completed a four-year college degree in 1970, compared to 36 percent in 2015. Human capital theory holds that this trend has been driven in large part by the expected payoff; as with all investments, people accumulate more human capital when they expect the returns to be higher.

The returns to college are high and growing: Students who complete a four-year undergraduate degree receive, on average, a large wage premium over those who do not, a premium that has been rising since the late 1970s. One analysis has concluded that workers with undergraduate degrees (and who stopped there) received 1.75 times the wages of a high-school-only graduate in 2005, up from 1.4 times in 1980 — a trend that economists believe is a reflection of changes in the demand for skills in a more high-tech-based economy. (Of course, the wage premium depends on the student's field, among other factors.)

Moreover, graduate and professional education is of growing importance to earnings: According to a 2012 study by Jonathan James, then of the Cleveland Fed, the college premium is increasingly conditional on the student also completing a graduate or professional degree. All of the growth in the college wage premium since the 2000s, James found, has gone to holders of advanced degrees.

But although higher education is a lucrative human-capital investment for many, it can also be a risky one. Around half of students who enter college end up leaving without a degree — perhaps as a result of inadequate preparation before college or personal difficulties — and the return to attending college without actually earning a degree is generally low. Thus, these students face a depressing combination of debt (or lost savings) and low earnings. Richmond Fed research director Kartik Athreya and co-author Janice Eberly of Northwestern University have argued that such risks have slowed the growth of college-going. (See also the Richmond Fed's *2017 Annual Report* essay, "Falling Short: Why Isn't the U.S. Producing More College Graduates?")

Young people who eschew the four-year college route will often still make investments in their human capital — through a two-year associate's degree, on-the-job experience, or formal job-based training programs such as apprenticeships. (See "Learning in the Fast Lane," *Econ Focus*, Fourth Quarter 2017.)

In Schultz's 1960 remarks on human capital, he noted one of its unusual attributes: Unlike typical investments in physical capital, investments in human capital — especially formal education — are often a consumption good as well, which has the effect of "improving the taste and quality of consumption of students throughout the rest of their lives." This, he said, may increase the true rate of return to education far above its observed financial rate of return. So take heart when your next student-loan payment is debited from your bank account. **EF**

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