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Unit 5 – Human Capital
Formation

Name: _____

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What is Human Capital?

Societies need sufficient human capital in the first place—in the form of competent people who have themselves been educated and trained as professors and other professionals. In other words, we need good human capital to produce other human capital (say, doctors, engineers...). This means that we need investment in human capital to produce more human capital out of human resources.

Sources of Human Capital

Investment in education is considered as one of the main sources of human capital. There are several other sources as well. Investments in health, on- thejob training, migration and information are the other sources of human capital formation

Spending on education by individuals is similar to spending on capital goods by companies with the objective of increasing future profits over a period of time. Likewise, individuals invest in education with the objective of increasing their future income. Like education, health is also considered as an important input for the development of a nation as much as it is important for the development of an individual

A sick labourer without access to medical facilities is compelled to abstain from work and there is loss of productivity. Hence, expenditure on health is an important source of human capital formation. Health expenditure directly increases the supply of healthy labour force and is, thus, a source of human capital formation.

Firms spend on giving on-the job-training to their workers. This may take different forms: one, the workers may be trained in the firm itself under the supervision of a skilled worker; two, the workers may be sent for off-campus training. In both these cases firms incur some expenses. Firms will, thus, insist that the workers should work for a specific period of time, after their on-the-job training, during which it can recover the benefits of the enhanced productivity owing to the training.

People migrate in search of jobs that fetch them higher salaries than what they may get in their native places. Unemployment is the reason for the rural-urban migration in India. Technically qualified persons, like engineers and doctors, migrate to other countries because of higher salaries that they may get in such countries. Migration in both these cases involves cost of transport, higher cost of living in the migrated places and psychic costs of living in a strange sociocultural setup.

People spend to acquire information relating to the labour market and other markets like education and health. For example, people want to know the level of salaries associated with various types of jobs, whether the educational institutions provide the right type of employable skills and at what cost. This information is necessary to make decisions regarding investments in human capital as well as for efficient utilisation of the acquired human capital stock. Expenditure incurred for acquiring information relating to the labour market and other markets is also a source of human capital formation.

Human Capital and Economic Growth

We know that the labour skill of an educated person is more than that of an uneducated person and that the former generates more income than the latter. Economic growth means the increase in real national income of a country; naturally, the contribution of the educated person to economic growth is more than that of an illiterate person. If a healthy person could provide uninterrupted labour supply for a longer period of time, then health is also an important factor for economic growth.

This enhanced productivity of human beings or human capital contributes substantially not only towards increasing labour productivity but also stimulates innovations and creates ability to absorb new technologies. Education provides knowledge to understand changes in society and scientific advancements, thus, facilitate inventions and innovations. Similarly, the availability of educated labour force facilitates adaptation to new technologies

India recognised the importance of human capital in economic growth long ago. The Seventh Five Year Plan says, “Human resources development has necessarily to be assigned a key role in any development strategy, particularly in a country with a large population. Trained and educated on sound lines, a large population can itself become an asset in accelerating economic growth and in ensuring social change in desired directions.”

Two independent reports on the Indian economy, in recent times, have identified that India would grow faster due to its strength in human capital formation. Deutsche Bank, a German bank, in its report on ‘Global Growth Centres’ (published on 1.7.05) identified that India will emerge as one among four major growth centres in the world by the year 2020.

World Bank, in its recent report, ‘India and the Knowledge Economy —Leveraging Strengths and Opportunities’, states that India should make a transition to the knowledge economy. The per capita income of India will increase from a little over US \$1000 in 2002 to US \$ 3000 in 2020. It further states that the Indian economy has all the key ingredients for making this transition, such as, a critical mass of skilled workers, a well-functioning democracy and a diversified science and technology infrastructure. Thus, the two reports point out the fact that further human capital formation in India will move its economy to a higher growth trajectory

Human Capital and Human Development

Human capital considers education and health to increase labour productivity. Human development is based on the idea that education and health are integral to human well-being because only when people can read and write and the ability to lead a long and healthy life, they will be able to make other choices which they value.

Human capital treats human beings to an end; the end being the increase in productivity investment in education and health is unproductive if it does not enhance output of goods and services. In the human development perspective, human beings are ends in themselves. Human welfare should be increased through investments in education and health even if such investments do not result in higher labour productivity.

Human Capital Formation in India: Great Prospects

In India, the ministries of education at the union and state level, departments of education and various organisations like National Council of Educational Research and Training (NCERT), University Grants Commission (UGC) and All India Council of Technical Education (AICTE) regulate the education sector. Similarly, the ministries of health at the union and state level, departments of health and various organisations like Indian Council for Medical Research (ICMR) regulate the health sector.

Education Sector in India

During 1952-2002, education expenditure as percentage of total government expenditure increased from 7.92 to 13.17 and as percentage of GDP increased from 0.64 to 4.02. Throughout this period the increase in education expenditure has not been uniform and there has been irregular rise and fall.

Elementary education takes a major share of total education expenditure and the share of the higher/tertiary education (institutions of higher learning like colleges, polytechnics and universities) is the least. Though, on an average, the government spends less on tertiary education, 'expenditure per student' in tertiary education is higher than that of elementary. This does not mean that financial resources should be transferred from tertiary education to elementary education

The per capita education expenditure differs considerably across states from as high as Rs 3,440 in Lakshadweep to as low as Rs 386 in Bihar. This leads to differences in educational opportunities and attainments across states. The Tapas Majumdar Committee, appointed by the Government of India in 1998, estimated an expenditure of around Rs 1.37 lakh crore over 10 years (1998-99 to 2006-07) to bring all Indian children in the age group of 6-14 years under the purview of school education. Compared to this desired level of education expenditure of around 6 per cent of GDP, the current level of a little over 4 per cent has been quite inadequate. In principle, a goal of 6 per cent needs to be reached—this has been accepted as a must for the coming years.

In the Union Budget 2000-05, the Government of India levied a 2 per cent 'education cess' on all union taxes. The government estimated to get a revenue of Rs 4,000-5,000 crore and the entire amount was earmarked for spending on elementary education.

Educational Achievements in India

Generally, educational achievements in a country are indicated in terms of adult literacy level, primary education completion rate and youth literacy rate.

Educational Attainment in India

SLNo.	Particulars	1990	2000
1.	Adult Literacy Rate (per cent of people aged 15+)		
	1.1 Male	61.9	68.4
	1.2 Female	37.9	45.4
2.	Primary completion rate (per cent of relevant age group)		
	2.1 Male	78	85
	2.2 Female	61	69
3.	Youth literacy rate (per cent of people aged 15+ to 24)		
	3.1 Male	76.6	79.7
	3.2 Female	54.2	64.8

Education for All — Still a Distant Dream

Though literacy rates for both — adults as well as youth — have increased, still the absolute number of illiterates in India is as much as India's population was at the time of independence. In 1950, when the Constitution of India was passed by the Constituent Assembly, it was noted in the Directives of the Constitution that the government should provide free and compulsory education for all children up to the age of 14 years within 10 years from the commencement of the Constitution.

Gender Equity — Better than Before

The differences in literacy rates between males and females are narrowing signifying a positive development in gender equity; still the need to promote education for women in India is imminent for various reasons such as improving economic independence and social status of women and because women education makes a favourable impact on fertility rate and health care of women and children

Higher Education — a Few Takers

The Indian education pyramid is steep indicating lesser and lesser number of people reaching the higher education level. Moreover, the level of unemployment among educated youth is the highest. As per NSSO data, in 2000, the unemployment rate of educated youth (Secondary Education and above) was 7.1 per cent and unemployment of people with up to primary education was only 1.2 per cent.