FEM 4204
HUMAN CAPITAL: THEORIES AND PERSPECTIVES

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OUTLINE

• Human Capital Theory*
• Household Production Theory*
• Altruism Theories*

* These are all utility maximization models
REFERENCES


• Rahmah Ismail (1996) Modal Manusia dan Perolehan Buruh, Dewan Bahasa & Pustaka
Human Capital Theory

- (Inter temporal choice) utility max
- **The Economists:** Schultz (1961) & Becker (1962)
- **The Theory:**
  - Deals with individual utility maximization over time
    - Choice between current vs. future consumption
    - I.e. if $U_c < U_f$ then, individual will **forego current consumption**
    - **Note:** Forgone current consumption = direct cost (e.g. cost of schooling) + opportunity cost + other non monetary cost (emotional cost of leaving the family etc) of investment
Human Capital Theory ... cont

- Depending on HH time preferences, HH will put aside a fraction of its current income as saving
  - The question is — what form will the saving take? Bonds, stocks, buy a house or investing in oneself/family members?

- The theory says:
  - Human capital can be added, built and produce return like other types of capital (i.e. financial capital)

- Consider an individual concerned only with monetary payoff to formal schooling
  - S/he will only invest in added schooling if payoff of added schooling ≥ payoff of the alternative invest (e.g. stocks, bonds, saving accounts etc) at the going market interest rate of \( r \).
Human Capital Theory ... cont

The return of education etc... will be discussed in detail later 😊
Household Production Theory

- (Extension to the traditional utility max)
- **The economist:** Gary Becker
- Here, consumer behavior is seen to be similar to that of a firm (role as **Buyer & Seller** in different market) ~ the **circular flow**
  - i.e. consumer DM is not restricted to the final goods market alone
  - Here, resource allocation or interaction with the factor market becomes part of the framework
Household Production Theory

- **The Theory:**
  - **Assume:** HH derives satisfaction from 3 composite goods
    - Market gd ~ C; Home goods ~ G; Leisure time ~ L
  - **The utility function:** $U = u(C, G, L)$
  - **Assume:** $C$ & $G$ are perfect substitutes, thus $U = u(C+G, L)$
  - **Time constraint:** $T = L + M + H$
  - **HH production function:** $G = g(H; X)$ where $X$ is mkt inputs (assumed fixed)
Household Production Theory

- The market work budget constraint:
  - Income = earned + unearned income
    \[ Y = E + V \]

  The family expenditure on mkt gds are PC, where P is the price index. Since expenditure exhaust income, so,
  \[ PC = Y = E + V \]

- But earning depend on how much time is spent on mkt work. If hourly wage rate is \( w \), so
  \[ E = wz \]
Household Production Theory

- **Note:** $E = wM$, so substituting it in the equation,
  
  $PC = wM + V$
  
  $PC = w(T-L) + V$ — i.e. if no HH production: $T = M+L$; $M = T-L$

  , so

  $PC + wL = wT + V$ — Full Income

- Full income represent the resources available to the household

- When wage rate increases — time allocation preferences will be revealed — e.g. work, HH wrk
Theory of Altruism

- In this model, a person, $h$, is effectively altruistic towards another member of his family, $w$, whom may be his child, spouse etc.
- “Altruistic” means that $h$’s utility function depends positively on the wellbeing of $w$. 
Theory of Altruism ... cont

• **Application:** Private bequest behaviors
• Parents intentionally or unintentionally make transfers to their descendents in numbers of ways:
  1. Biological transfers of natural talents and abilities
  2. Purchases of educations and other human capitals
  3. Gifts
  4. Bequest of tangible and financial properties
Theory of Altruism ... cont

• In altruistic model,
  – a parent HH cares not only about its own lifetime consumption of its descendents
To be continue