

Human capital

Investing in Human Capital: Policy Priorities for Canada

W. Craig Riddell

Comments:

“Smart Human Capital Policy: An Alternative Perspective”

Serge Coulombe

“Education and Human Capital: Reconciling Policy Imperatives and Policy Design”

Jane Gaskell

EXECUTIVE SUMMARY

In confronting the challenge of improving human capital formation in Canada, Craig Riddell provides a comprehensive overview of the evidence on the private and social returns to education and makes a strong case for increasing investment for particular segments of the population.

In presenting his policy package, Riddell emphasizes that large returns to existing expenditures in education do not imply that additional public investments are warranted. What matters more is the return at the margin — the return on additional expenditures — which is likely to be highest in areas in which we currently devote relatively limited resources to skills formation.

The commentators provided their own perspectives of Riddell’s chosen policies. Serge Coulombe presented an alternative cost-benefit analysis and suggested that a “smarter” immigration selection process would be a more effective way to develop human capital. Jane Gaskell observed that many details about program design — including federal-provincial jurisdictional issues and the structure and content of programs — were glossed over, but may matter a great deal in achieving the desired objectives.



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SCOPE OF THE CHALLENGE

Human capital development has become a prominent issue of public policy. With the rise of the knowledge economy and rapid technological change, there is growing demand for highly skilled, adaptable workers. Empirical studies consistently demonstrate that future growth in GDP is directly related to the knowledge and skills of the labour force.

An individual's human capital is determined by many factors, both hereditary and environmental. Three important factors that public policy can influence are the nutrition and stimuli received in the early years of life, formal education, and skills and knowledge acquired by work experience and training.

Riddell's review of available empirical evidence leads him to two main conclusions. First, past policy interventions that raised educational attainment typically had large beneficial effects on the affected individuals, in terms of both labour market and health outcomes. Second, human capital investments also yield important nonmarket and social benefits, such as increased civic participation and reduced participation in criminal activities as well as higher rates of innovation and the associated increased growth in living standards. Investing in the human capital of those with limited skills has thus become a key component of social and economic policy: governments aim to facilitate individual adjustment to structural economic change. According to this view, education is a mechanism for promoting equality of opportunity and social mobility.

Riddell notes that the proportion of post-secondary education funded by Canadian governments has declined in recent years and is now well below the OECD average. He also observes that Canada ranks near the bottom of OECD countries with respect to spending on early childhood education. A consequence of reduced public expenditure is a decline in the quality of education, most evident at the university level. Another is a widening of earnings differentials by educational attainment, which would suggest that the supply of highly educated workers is not keeping up with demand.

OPTIONS FOR ADDRESSING THE CHALLENGE

Riddell argues that government intervention in human capital development is justified on both equity and efficiency grounds.

Efficiency arguments are based on three market imperfections. First, because benefits to society are not taken into account in the private decision on how much schooling to acquire, there would likely be underinvestment in education in the absence of government intervention. Second, there are credit market failures because potential students cannot use their human capital as collateral for education loans. Finally, some evidence suggests that education markets suffer from imperfect and incomplete information on the quality of programs, making it difficult for students and parents to make informed decisions.

Equity rationales for government intervention involve the promotion of equal opportunity, social mobility and a more equal distribution of economic rewards.

With these criteria in mind, Riddell argues that three key dimensions of the human capital policy challenge deserve attention:

- ▼ Public expenditure in Canada on skills formation has been losing out to other priorities at a time when the economic importance of human capital is growing.
- ▼ Additional public investment should be directed to areas that have high potential returns (both private and social), and that would otherwise receive insufficient private investment.
- ▼ An important aspect of Canada's current situation is that the inadequate skills of some groups present a barrier to their maintaining a decent standard of living and participating fully in society. Policies ought to narrow gaps in educational attainment and skills among key subsets of the population for both equity and efficiency reasons.

THREE PREFERRED POLICIES

Increase public support for early childhood education and care (ECEC)

Based on overwhelming evidence of large benefits relative to costs, Riddell proposes an ECEC program targeted toward children at risk of developmental and educational failure. The program would include a mix of public and private providers or private providers alone; standards to ensure quality service provision; and vouchers paid directly to families to encourage the participation of families with a wide range of educational and income characteristics. While Riddell presents arguments for and against a targeted approach as opposed to a universal system, he opts for the former in order to maximize the return to public investment. However, he points out that given Canada's limited experience with ECEC, there is considerable scope for experimentation and expansion based on careful policy evaluation, a point on which Gaskell agreed.

Increase the compulsory school attendance age to 18 and improve programs in secondary school for those at risk of dropping out

Data from the 2001 census reveal that about 20 percent of Canadians in their 20s have neither completed high school nor obtained any post-secondary education, and this proportion is significantly higher in rural areas and among Aboriginal students. Based on evidence that shows significant gains from an additional year of school, Riddell proposes a statutory increase in the school-leaving age coupled with programs to encourage children to stay in school. Coulombe cautioned that keeping 17- and 18-year-olds in school against their will might create as many problems as it solves, but agreed that investing in their human capital development would pay dividends.

Increase merit-based post-secondary scholarships for students from low-income families

With the increasing cost and importance of post-secondary education, there are reasons to be concerned about ensuring equitable access for students in low-income families. Riddell's preferred approach would be to expand the program of grants to low- and moderate-income families as the US has done since the early 1990s. This would be accompanied by a dereg-

THREE POLICY PROPOSALS TO ADDRESS THE HUMAN CAPITAL CHALLENGE

- ▼ **Increase support for early childhood education for vulnerable children.** Riddell notes that there is strong empirical evidence that targeted investments have large payoffs, and Canada invests few public resources in this area. He argues that a universal approach would be much less cost-effective, since it would subsidize many children whose parents would otherwise have paid the full cost for such care. Nonetheless, he admits there are difficulties in identifying at-risk groups.
- ▼ **Reduce the high school dropout rate.** Riddell proposes an increase in the statutory school-leaving age to 17 or 18, with complementary programs to encourage potential dropouts to stay in school. These programs could take the form of vocational and technical training as well as cooperative education.
- ▼ **Improve equity in university access.** Noting that the propensity to attend university increases sharply with parental income, Riddell suggests instituting a program of generous merit-based university scholarships for low-income students. Coupled with easing restrictions on tuition increases, this would improve access to a university education while giving universities the resources they need to maintain their high quality.


ulation of tuition fees, allowing universities and colleges to invest in quality improvements. Gaskell cautioned that given the current complex array of student aid programs, the design of any new initiative must be simple, transparent and well understood by parents and voters if it is to increase access and succeed politically.

In providing an overall assessment of Riddell's policy package, Gaskell commented that more attention must be given to the intergovernmental, institutional and social contexts when assessing the effectiveness of policies of educational investment.

Coulombe questioned the cost-effectiveness of Riddell's proposals, arguing that the policies would devote substantial public resources to some areas in which Canada already performs quite well. A "smarter" policy in his view would be to adjust Canada's international immigration selection process toward selecting those with skills that are valued in the Canadian labour market. He also cited the need for better assessment of foreign educational credentials.

CONCLUSION

Riddell's policy package builds on available evidence on the economic and social benefits of public investment in education and skills. In his view, all three interventions would provide a high return to additional investment and address important gaps in human capital formation that result in low skills and unequal opportunity among some groups.



Additional public investment should be directed to areas that have high potential returns and that would otherwise receive insufficient private investment.

THE CANADIAN PRIORITIES AGENDA

The IRPP's Canadian Priorities Agenda project is designed to initiate a broad-based and informed public debate on policy choices and priorities for Canada over the medium term. Research papers by some of Canada's foremost scholars examine the most effective ways to address the following eight broad policy challenges:

- Human capital
- Climate change
- Natural capital
- Population aging
- Economic security
- Health outcomes
- Productivity
- Trade and globalization

Based on the results of this research, six judges, among Canada's top policy thinkers, each crafted from the eight papers a policy package of the specific recommendations that in his or her view will best enhance the economic and social well-being of Canadians.