

Human Capital Index - Why Should Governments and Employers Take It Seriously?

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Abstract

The purpose of this paper is to provide an analysis of the importance of Human Capital Index for the socio-economic condition of a country, and why governments and private institutions should closely monitor and follow these factors using the example of Georgia.

According to the World Bank, Human capital consists of the knowledge, skills and health that people invest in and accumulate throughout their lives, enabling them to realize their potential as productive members of society.

Besides the fact that investments in financial assets and physical capital traditionally dominates in economic relations, human capital still plays an important role in ensuring economic growth, productivity and innovation.

The Human Capital Index (HCI) was launched by the World Bank in 2018 as a measurement of economic success. The index ranks member countries according to outcomes they achieve in health and education, and highlights how this progress can help improve the productivity of the new generation of workforces.

According to HCI 2020 report, nearly 60% of children born today would be just half as productive as they would have been with full education and healthcare. This reflects a serious crisis in human capital especially in developing countries, with major implications for economic growth and the global effort to end extreme poverty by 2030.

The government must ensure that all children receive a comprehensive package of education and healthcare services during critical periods of childhood to achieve their full potential. Policymakers must ensure that youth are well prepared to enter the labor market as healthy, skilled and productive adults, and are able to acquire necessary knowledge and professional competencies.

Keywords: Human Capital Index, Human Development, Human Capital, Economic Growth

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Introduction

Human capital broadly refers to the educational attainment, knowledge, skills and experience possessed by workers in an economy. It provides economic value as a skilled and experienced employees lead to increased productivity and contribute in economic growth.

According to the World Bank, Human capital consists of the knowledge, skills and health that people invest in and accumulate throughout their lives, enabling them to realize their potential as productive members of society. Investing in people through nutrition, health care, quality education, jobs and skills helps to develop human capital, and this is key to ending extreme poverty and creating more inclusive societies (World Bank, 2020).

Besides the fact that investments in financial assets and physical capital traditionally

dominates in economic relations, human capital still plays an important role in ensuring sustainable economic growth, improved productivity and innovation.

According to human capital theory, a growing economy can be attributed to a well-invested workforce: a more educated population is likely to earn and spend more money, which in turn stimulates the further economic growth.

Increased human capital is associated with higher incomes for individuals, employers and countries as well as stronger social cohesion. It can be a central driver of sustainable growth, social inclusion and poverty reduction.

At the same time, human capital tends to migrate in a context of global economy: there is often a shift from low-income and rural areas to more developed places. Accordingly, less developed regions still remain underdeveloped,

while others become even more developed.

Human capital also tends to depreciate due to long periods of unemployment and failure to keep up with innovation and technological progress.

Human Capital Index: why this should be taken seriously by the governments and employers?

The Human Capital Index (HCI) was launched in 2018 by the World Bank as part of the human capital project, a global effort to accelerate progress towards a world where all children can achieve their full potential. The project aims to help create political space for national leaders to prioritize transformational investments in health, education and social protection (World Bank, 2020).

The main goal of the project is to make rapid progress towards a better world in which all children are well-nourished and ready to learn, can obtain real learning in the classroom, and enter the workforce as healthy, skilled and productive adults.

Central to this effort has been the Human Capital Index (HCI), a cross-country metric measuring the human capital that a child born today can expect to attain by his or her 18th birthday, given the risks of poor health and education prevailing in her country (World Bank, 2020).

The HCI follows the trajectory from birth to adulthood of a child born today, and quantitatively reflects the stages in this trajectory as well as their consequences for the productivity of the next generation of workers, including the following three components:

Component 1: Survival. Measured by using the under-5 mortality rate.

Component 2: School. Combines information on the quantity and quality of education:

- a. Quantity of education: number of expected years of school a child would complete by age 18;
- b. Quality of education: test scores from major international student achievements that are used to convert

expected years of school into quality-adjusted years of school.

Component 3: Health. Two proxies are used for health environment:

- a) Healthy growth among children under age 5 - fraction of children who are not stunted;
- b) Adult survival rate - share of 15 year olds who survive until age 60.

Using estimates of the economic returns to education and healthcare, these components are combined into an index that reflects the expected productivity of a child born today as a future worker, relative to a benchmark of complete education and full health (World Bank, 2020).

The Human Capital Index mainly focuses on human capital rather than human development, excluding aspects such as living standards measured by gross national income per capita - one of the components of Human Development Index.

The HCI ranks countries according to outcomes they achieve in health and education, and highlights how this progress can help improve the productivity of the next generation of workers. As one of the indicators of economic success, HCI should influence countries and their governments to invest more in health and education for greater equity and economic growth.

However, more spending does not necessarily lead to better outcomes, as the issue has more to do with the efficiency, consistency and cost-effectiveness of such spending.

According to the first edition of the Human Capital Index, published by the World Bank Group in October 2018 and updated in 2020, a child born today can expect, on average, to be 56 percent as productive when grows up as he or she would have been with full education and healthcare (World Bank, 2020).

Although 56% does not seem like a very high and attractive position, even this masks significant variations between different regions and economies. For example, a child born in a low-income country can expect to be 37 percent more productive than if he or she were fully educated and healthy. For a child born in a high-income country the figure is 70 percent. So, the

difference in human capital potential between low- and high-income countries is almost twice as large.

This means that children born today in a low-income country may not be able to find a job in the future, and even if they do, it may not be a job in which their human capital can be utilized effectively. This demonstrates a serious human capital crisis, especially for developing and emerging market countries, with major implications for economic growth and the global effort to end extreme poverty by 2030.

Although many countries have made tangible progress in improving human capital over the past decade, the covid-19 pandemic has threatened to reverse many of these gains. Consequently, additional efforts and actions are needed to protect hard-won gains in human capital, especially among the vulnerable poor

and less developed regions.

We can assess the importance of HCI in more detail by analyzing the human capital situation in a particular country, using the example of Georgia.

According to HCI 2020 report, Georgia was ranked 85th among 174 participating countries with a score of 0.57, meaning that child born in Georgia in 2020 is expected to grow up to be only 57 percent as productive as he or she could be if enjoyed complete education and full health.

Although the overall HCI value for Georgia increased from 0.54 to 0.57 in 2010-2020, it decreased from 0.61 to 0.57 during 2018-2020, most likely due to the negative impact of the pandemic.

Table 1 below illustrates the human capital index for Georgia as of 2020, broken down by gender and HCI components (World Bank, 2022)

HCI Components	Boys	Girls	Overall	Rank
Probability of Survival to Age 5	0.99	0.99	0.99	63
Expected Years of School	12.8	13.1	12.9	55
Learning-adjusted Years of School	8.0	8.6	8.3	81
Harmonized Test Scores	391	410	400	101
Adult Survival Rate	0.78	0.92	0.85	99
HCI	0.53	0.61	0.57	85

Table 1. HCI for Georgia, 2020

As table #1 shows, Georgia has a fairly high probability of surviving rate. 99 out of 100 children born in Georgia survive to the age of 5 (ranks #63 among 174 participated countries).

Child who starts schooling in Georgia can expect to complete 12.9 years of school by his or her 18th birthday (#55 in the ranking).

However, the learning-adjusted years of school, factoring in what children actually learn, is only 8.3 years (#81 in the global ranking). So, by adjusting the school years according to the level of education, a period of 12.5 years is equivalent to 8.9 years, and the loss is 3.6 years which is an alarming gap.

As to the harmonized test scores, students in Georgia score 400 on a scale where 625 represents advanced attainment and 300 minimum attainment (#101 in the ranking). This is the lowest score among the all HCI components for Georgia.

And finally, only 85 percent of 15-year olds

will survive until age 60 across Georgia (#99 in the global ranking). This statistic is a proxy for the range of health risks that a child born today would experience as an adult under current conditions (World Bank, 2022).

Notably, the HCI score for girls is higher than for boys (0.61 and 0.53 respectively), with girls having higher harmonized test scores, years of schooling and adult survival rates.

If compare the HCI data among regional and other comparable/peer countries, Georgia's overall 0.57 HCI represents a worst score in comparison to all neighboring countries, and lower than the average for the Europe and Central Asia region

Table 2 shows the HCI comparison between Georgia and neighboring countries as of 2020 (World Bank, 2022).

Country	HCI	Rank
Russia	0.68	41
Turkey	0.65	48
Armenia	0.58	81
Azerbaijan	0.58	82
Georgia	0.57	85

Table 2. HCI comparison of Georgia and neighboring countries, 2020

In 2022, government spending on education in Georgia was 3.7% of GDP, up from 3.2% in 2010 but down from 4.4% in 2019. Although spending on education has tripled over the past decade, this figure is still low compared to the EU, where spending on education is around 5% of GDP, with highest level in Sweden (7.3 %) and Denmark (6.9%), and lowest (3.1%) in Romania (Eurostat, 2022).

As to the healthcare sector, public spending on healthcare in Georgia was 3.6% of GDP in 2020, which is lower than the average EU rate (10.9%) and the World Health Organization's recommended minimum - 5%. Prices in the healthcare services and medicines increased by 64% during 2016-2021, and only 17% of the population uses private insurance in the country (IDFI, 2022).

This comparison clearly and undoubtedly emphasizes the need for improvement the quality, quantity and structure of investments in education and healthcare system in Georgia.

The government must provide all children with a comprehensive package of education and healthcare services during critical periods of childhood, to achieve their full potential in the future.

Governments have a responsibility and a vital role to play in creating and improving human capital by directly funding and providing or regulating the private provision of social services while ensuring equal access to opportunity.

Policymakers must ensure that youth are well prepared to enter the competitive labor market as healthy, skilled and productive adults, and are able to acquire necessary knowledge and professional competencies. This will greatly lead the country towards better social inclusion, sustainable development and economic growth.

Improving the quality and investment in the education and health sector is also undoubtedly important for potential employers, as high qualified, skilled and healthy workforces are one of the main sources to achieve long term business objectives and ensure sustainable institutional growth and development.

Ignoring HCI factors can lead to further deterioration and depreciation of human capital, which will be reflected in their migration to highly developed areas, increasing inequality, social exclusion and political instability.

Conclusion

Although investments in financial assets and physical capital traditionally dominates in economic relations, human capital still plays an important role in ensuring sustainable economic growth, improved productivity and innovation.

The key findings of analysis of the Human Capital Index 2020 report shows that the children born today in a low-income countries may not be able to find an adequate job in the future, and even if they do, it may not be a job in which their human capital can be utilized effectively. This reflects a serious human capital crisis in emerging market countries with major implications for economic growth and the global effort to end extreme poverty by 2030 (World Bank).

Gaps in human capital are at risk of further widening amid rapid global changes in technology, demography, fragility, migration and climate change. The analysis clearly emphasizes the need for improvement the quality, quantity and structure of investments in education and healthcare by the governments and private sector.

The government must ensure that all children have a comprehensive package of education and healthcare services during critical periods of childhood to achieve their full potential in the future.

Private institutions should recognize importance of human capital for achieving their business goals, and invest more in training, education, professional development and better working conditions for their current and future potential employees.

Youth should be well prepared to enter the labor market as healthy, skilled and productive

adults, and be able to acquire necessary knowledge and professional competencies, which, in turn, will greatly lead the country and its private sector towards better inclusive society, sustainable development and economic growth.

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