



***International Association of Economic and Social Councils
and Similar Institutions
(AICESIS)***

***NATIONAL HUMAN CAPITAL AND NEW SOURCES OF
NATIONAL COMPETITIVENESS***

Report

1- With economic globalization processes winding down, and almost all nations having been involved in the global system of division of labor, the living standards get more and more dependent on national competitiveness. Analysis shows that at the present stage of social and economic development, the growth of national competitiveness is a function of human capital development. Up to 80 percent of wealth produced in developed countries and up to 60 percent in case of poor countries depend on intangible assets: “human capital and the value of institutions (as measured by rule of law) constitute the largest share of wealth in virtually all countries.”¹

I- New models of the economic growth and national competitiveness.

2- Growth of national living standards based on enhancement of national competitiveness appears to be the necessary precondition for social and political stability and, subsequently, for further social and economic progress. Enhancement of national competitiveness is currently one of the key priorities on national agendas.

3- National competitiveness in a large part depends on a threshold level of workforce productivity providing for the best possible flexible combination of material and human resources. Competition between market products with inevitably shortening life cycles is no longer as important as competition between social institutions.²

4- Long-term sustainable development benefits civil societies in the first instance. Thus, their mission is to promote enhancement of national competitiveness as a priority issue on national agendas, and search for safeguards against political volatility.

5- The current global economic crisis has not only altered the structure of international economic relations but also affected the structure and influence of the key economic development factors, namely, human capital, financial capital, and technologies.

¹ World Bank, *The Wealth of Nations: Measuring Capital for the 21st Century*, DC, 2007

² CNES of Algeria.

6- Still ongoing economic crisis has brought about new trends exerting significant, however varying, influence on the levels of national competitiveness.

7- The proper perception of these changes is necessary in order to make adequate adjustments to economic development strategies of both advanced and developing economies. First thing not to be overlooked in this context is the growing role of human capital for enhancement of national competitiveness³. **These strategies should forge a balance between economic efficiency and social cohesion.**

8- These strategies should address the new trends in the global economy as well as the entire set of all potentially and already available resources which could be used in the actual global, regional, and national social and economic conditions. At the same time, these strategies should be more oriented towards social and economic growth dimensions. In this regard, Professor Paul Krugman, Nobel Prize winner, stressed: “Economics is marked by a startling crudeness in the way it thinks about individuals and their motivations, yet it builds a huge structure on the basis of the these simplistic foundation”⁴.

9- National policymakers should focus on the following emerging global trends:

- a) **The crisis has significantly reduced cross border capital flows. As estimated by the McKinsey Global Institute, in 2007 financial flows between the G20 economies constituted 18% of their aggregate GDP; up to date it has reduced to less than 4.5%, while in the global it has dropped by 60%.⁵**
- b) **Worldwide distribution of industrial production has undergone changes. In emerging markets production has taken a bigger role, the process is often dubbed as “reindustrialization”. Along with a trend to bring traditional industries back from the emerging countries to the developed ones, the advanced economies have intensified development of new industries with relatively lower labor costs and growing importance of such factors as proximity of research infrastructure (due to increasingly high role of R&D) as well as consumer demand. This process is additionally contributed to by a rise in labor costs in the top developing nations, notably those in Southeast Asia.**
- c) **Global economy would be increasingly impacted by cheaper energy prices due to brand new technologies of extraction of unconventional natural gas and oil, and their transportation. This would lead to a kind of revolution in energy prices, which also has to be viewed as a factor of reindustrialization.**
- d) **Global institutional changes will play a significant role. Relatively stricter regulation would, probably, manifest itself in stricter regulations on financial markets – both on national and global levels. Relative rise in importance of regulatory framework will, probably, manifest itself in**

³ In this report the “human capital” concept is used to estimate impact of educational, professional training and qualification, and public health (among other factors) on economic performance. In modern macroeconomic models this concept is instrumental in estimating impact of social investment on economic growth and improvement of national competitiveness. In many cases, this concept makes it easier to convince decision-makers (including representatives of international financial institutions) to invest in society and develop the institutions that are necessary for it. Like any other indicator, human capital eliminates many variables that are very important in other domains. Thus, the concept of human capital is hardly applicable when it is necessary to consider specific socio-economic conditions, political and economic interests of various social groups.

⁴ Contribution of Sociaal –Economische Raad, Curaçao.

⁵ Vladimir Mau. The global crisis goes through the equator: the shape of the postcrisis economy. Vedomosti.ru. 03.02.2014.

stricter regulations on financial markets – both on national and global levels.

- e) Developing nations have suffered significant reduction of opportunities to capitalize on an economic growth model based on cheap, well-disciplined and relatively educated labor, inflow of capital, technologies and management skills, and organization of mass production. This model used to provide competitiveness of production through its low cost. Slowdown in global demand for this kind of production and sizeable technological shifts have significantly limited the opportunities for using this model in order to relocate production to new countries or significantly expand it within already existing production clusters.

10- ‘Reindustrialization’ strategies employed by a number of developed economies aimed at bringing production back from the developing countries where transnational corporations had earlier allocated them also drastically reduce the viability of this old model.

11- Economic development of this group of countries largely depends on a raw materials sector. It’s worth mentioning that expansion of the raw materials sector in developing countries features a high level of assumed costs (machinery and equipment, technologies, and management) and does not create any noticeable demand neither for highly-qualified labor, nor for high-quality education or fundamental/applied research.

12- Countries of this group will need to advance new models of development requiring better institutions and enhanced human capital if they are to relocate national wealth. Shift to those models is significantly limited by ‘brain drain’, i.e. uncompensated export of human capital to developed and middle-income economies. As a result, developing countries bear double losses – direct budget expenditures on future immigrants, and indirect loss of opportunities for development of high-margin sectors requiring enhanced human capital.

13- By some assessments, these losses exceed assistance provided by the developed economies to the developing ones.

14- ‘Brain drain’ phenomenon is a very delicate subject of discussion. This phenomenon appears in very different socio-economic contexts with different consequences. The ‘brain drain’ does not only appear between developing and developed countries but also within regions with high levels of economic development, such as Europe.

15- Policies in this domain are being re-evaluated in the light of the transformations in the global economy that have resulted from the transformation of the role played by emerging economies.

16- Education is a long-term transforming element that facilitates this transformation. Enabling income increases for the poor, strengthening the labor market and enhancing domestic markets we could generate movement towards higher rates of growth along with macroeconomic consistency. Education as a key development factor, actions to strengthen the labor market and increase investment capacity while retaining macroeconomic responsibility should be our top priority.

- a) Development options in middle-income economies are seriously limited by increase in the costs of mass production spurred by improvement of living standards and, correspondingly, growth of salaries, which gradually makes mass production in these countries non-competitive. At the same time, these economies struggle to tap into the markets of hi-tech

products or high-margin services, which have already been occupied by the highly developed economies. People's demands require significant budget expenditures, however economic systems fail to meet them. Budget limitations encumber implementation of programs necessary to increase national competitiveness and overcome the middle-income trap.

b) Developed countries have been faced with the challenge of bolstering economic growth rates that would correspond to the rising expectations of the people. The high degree of economic development in these countries has been maintained by the dominant role of high-margin, primarily financial services, as well as real industries with significant value added, which are based ultimately upon good institutions and accumulated human capital.

17- A number of developed countries have been badly affected by deindustrialization, and relocation of highly competitive mass production to countries with lower labor costs. Poor timing of job creation in the 'new' sectors causes structural unemployment problems. High living standards in these countries reduce work motivation for younger generations. In these economies, the demand structure tends to differ noticeably from the employment structure, which accounts for stable structural unemployment – among the young people in the first place.

18- Maintaining national competitiveness in this group of countries requires enhanced human capital. Educating and training the workforce in order to access, and adopt state of the art technologies will eventually lead to higher productivity. Without efficient human capital there will be no efficiency of technology whatsoever.⁶

19- In some of such developed countries this problem has been solved predominantly at the account of uncompensated inflow of human capital from developing and middle-income countries. For a number of countries, free-of-charge inflow of qualified labor force is a significant factor of economic growth.

20- New factors related to technological development and imbalances of the financial system should not be overlooked when attempting a shift to the new models of economic growth:

- a) new technology waves, emergence of new products and breakthrough technologies in various sectors of economy, social and political life mount a huge challenge to all national economies. Development of these technologies and their timely use have become a key factor of national competitiveness. Involvement of national economies in development and implementation of such technologies depend heavily upon the quality of institutions and human capital. **Competitiveness based on rational use of human capital is inextricably connected with innovation – in particular, with risks of lack of innovative activity, which are obviously more daunting than risks of innovation cycle for transition economies;**
- b) robotics and innovation reduce costs of mass production and bring down the threshold of labor costs, thus providing for cost competitiveness of specific products. This creates opportunities for reindustrialization and return of mass production back to developed and middle-income countries;
- c) fiscal problems encountered by many – including the developed and middle-income – economies limit investment in human capital development: education, healthcare, and social progress. These problems aggravate the conflict between the need for national competitiveness growth, on the one hand, and the real capacities for human capital enhancement, on the other;

⁶ Contribution of Sociaal –Economische Raad, Curaçao.

- d) development of global financial markets is now affected by their high volatility and excessive impact of speculative factors which often detach market estimates from basic corporate and national economic indexes. This hinders reflection of positive national competitiveness trends in financial market indicators;
- e) modern political systems, whose planning horizons are usually restricted within electoral cycles, have a hard time shaping long-term strategies for enhancement of national competitiveness and human capital.

21- New strategic priorities for a new cycle include the following factors: economic growth; industry strengthening; increased competitiveness; active integration in global economy; raising living standards and social indicators; a knowledge-based economy with higher R&D&I that tackles inequality as its main goal.

22- Leading national actors will have to estimate risks of turning this strategy into an instrument of ‘perverse’ success (i.e. higher economic growth, modernization and strengthening of industry, advances in R&D&I, along with remaining or even increasing inequalities), rather than an instrument to enhance national competitiveness.⁷

23- Also, the part of this strategy should focus on expansion of innovative investment, as well as national competitiveness.

II- The civil society and the human capital.

24- In modern world, development of such strategies requires a broad national consensus involving specific resources of civil society to strengthen the role of the values of tolerance, respect, national dialogue, and ethics in functioning of social institutes.

25- This consensus should, mainly, be based on general recognition of the fact that inequality is a structural impediment to development, since it limits growth in addition to turning it into an instrument of income concentration. Social, regional, racial, ethnic and gender equity should be the guiding principle of public policies to address the inequality challenge.

26- Economic, social and political institutions are impacted by civil society in a big way. **Requirements of efficient management of various types of enterprises, administrative institutions and industries nowadays are even more important as these actors are increasingly interconnected with numerous stakeholders, including civil society, which has to be more engaged in the decision-making process.**

27- This impact hinges upon the contribution of civil society to creation of trust to the institutional system regulating economic, social, and political relations. Lack of this trust leads to increased opportunism, large-scale violations of laws, less efficient institutional environment, and, subsequently, fewer opportunities for national competitiveness enhancement.

28- Civil societies may impact institutions using a powerful tool of civilian control based on implementation of the inherent national ethical norms in the institutional frameworks of corresponding nations. Civilian control is the necessary condition for fighting corruption, which in many countries dramatically reduces quality of institutions and impedes enhancement of national competitiveness.

⁷ CDES of Brazil.

29- Similarly, institutions are highly dependent on national dialogue which makes it possible to identify dysfunctions in the institutional frameworks and find adequate responses based on a balance of interests. Open national dialogue with participation of the key stakeholders is another important factor of strengthening mutual trust between participants of the national dialogue and facilitating institutions efficiency.

30- For instance, as a result of an inclusive national dialogue facilitated by the Economic and Social Council of the Dominican Republic the Education Pact was adopted as a part of the National Vision 2030. The Education Pact is to change the education system in order to transform the country at both economic and social level.

31- For the Dominican Republic the solution to the problems of inequality and youth unemployment was found in the transformation of the education system bearing the idea that through better education youth unemployment will decrease, and social mobility will increase.⁸

32- The goal of enhancing national competitiveness on the basis of human capital implies noticeable involvement of national economic and social councils, as well as AICESIS.

33- The idea of human capital in its contemporary form was put forward by T.W. Schultz, a renowned American economist and Nobel Laureate, in late 1950s and early 1960s⁹.

34- In a contemporary economic theory, human capital is usually conceived as a wealth of knowledge, skills and capabilities of a human being that can be used both for production and consumption. It is human because it manifests itself through a human personality, it is a capital because it serves as a source of either future incomes or future satisfactions or a combination of both. A broad definition, proposed by experts of OECD, embraces market as well as nonmarket aspects of investing in human capital. This definition describes human capital as “the knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being”¹⁰.

35- Human capital is a term fully in line with a standard definition of capital assumed within economic science. In this respect, investment in a person represents a form of allocation of resources in time, with present goods being traded for future ones.

36- Distinctive feature of human capital is its inseparability from a personality of its owner. However, in everything else human capital is no different than physical capital, as it is also a durable good though with a limited lifespan; like any non-renewable resource it inflicts amortization and maintenance costs; it may become morally obsolete even before its physical depletion; its value may rise and fall depending on fluctuations in supply of complementary factors of production and in demand for cumulative products.¹¹

37- The notion of monetary value of human capital has a long-standing history of more than three centuries. First calculation of a kind was made by W. Petty in as far back as 17th century.

⁸ Contribution of the Economic and Social Council of the Dominican Republic, Sociaal –Economische Raad, Curaçao.

⁹ Schultz T. W. (1961). Investment in Human Capital // American Economic Review. Vol. 51, No 1. P. 1-17. Schultz T. W. (1963). The Economic Value of Education. N.Y.: Columbia University Press.

¹⁰ . The Well-being of Nations: The Role of Human and Social Capital. Paris: OECD.

¹¹ Р. Капелюшников. Сколько стоит человеческий капитал России?. «Вопросы экономики», 2013. №1. С.27.

38- Attention towards the issue of human capital revived halfway through the 20th century, which was associated with the names of T.W. Schultz, G.S. Becker and J. Minzer. The idea stipulating that human knowledge, skills and competencies are another form of capital briefly gained universal recognition. A pioneering research by D.W. Jorgenson and B.M. Fraumeni that introduced a serviceable operational method of evaluation of human capital on the example of the United States created conditions necessary for further development of this concept.¹²

39- National economic and social councils, being an integral part of civil society, are destined to become influential actors in development and subsequent implementation of strategies for national competitiveness enhancement.

40- High-quality and accessible education is necessary for improving human capital quality. In this regard, it is important that the following specific points are taken into account:

- a) **Education is a public good and is largely dependent on budgetary costs, which were reduced as a result of the crisis;**
- b) **Besides better funding, education in many countries is also in need of reforms that would enable to meet the requirements of the labor market and avoid deepening structural unemployment. A national strategy would not only improve quality of education but also adapt educational standards to the skills required by employers;**
- c) **Finally, every citizen of his/her respective country should have the right to education, however there are still obstacles in access to it - regional, economic, social, and even such relating to various forms of discrimination.**

41- As active participants of the national dialogue, economic and social councils (ESCs) are designed to express the views shared by the stakeholders groups in regard to the structure of national priorities and formulation of problems which strategies for national competitiveness enhancement should be focused on. ESCs are intended to stimulate governments' efforts to work out and actively implement these strategies. Of crucial importance is the role played by ESCs in expert examination of these strategies, analysis of their feasibility, and evaluation of how efficiently all available and the deployed resources are used.

42- ESCs play a crucial role in development of a social partnership system, a necessary condition for increasing contribution of human capital to enhancement of national competitiveness. ESC might be involved in specific areas of action of social partners – vocational training and on-going training, human resources management within companies, etc.

43- ESCs should stimulate government's efforts aimed to promote strategies of national competitiveness enhancement, be actively engaged in these activities. ESCs are instrumental in examining these strategies, analyzing their feasibility, evaluating efficiency of available and mobilized resources.

¹² *Jorgenson D. W., Fraumeni B. M. (1989). The Accumulation of Human and Nonhuman Capital, 1948 — 1984 // The Measurement of Savings, Investment and Wealth / R. E. Lipsev, H. S. Tice (eds.). Chicago: The University of Chicago Press.*

Jorgenson D. W., Fraumeni B. M. (1992). The Output of the Education Sector // Output Measurement in the Services Sector / Z. Griliches (ed.). Chicago: University of Chicago Press.

44- ESCs should present themselves to civil groups and the public in general, to get their input on one hand, and to let the public know what they are actually doing on the other hand. ESCs need the input from civil society, and the integration of their ideas in the advices of ESCs will make the ESCs more known to the public.

45- ESCs constitute an essential part of the civilian control system with capabilities for intensive interaction with civil society structures involved in these activities. ESCs are designed to monitor development and, more importantly, implementation of the respective strategies and provide for their timely adjustment to rapidly changing environment.

46- ESCs are actively involved in the process of national human capital enhancement, as their involvement is critical for the analysis of the problems and obstacles standing in the way. Another priority of ESCs is elaboration of institutional means for human capital enhancement based on understanding of key stakeholders' problems and interests. Systematic monitoring of human capital enhancement, identification of problems in the course of national strategies implementation are highly important as well.

47- Given the magnitude of development and implementation of national strategies for competitiveness enhancement on the basis of human capital, AICESIS should:

- a) ensure the exchange of information between national ESCs on the best methods and practices for development and implementation of the respective strategies. **AICESIS would collect and analyze these practices, methods and experiences;**
- b) establish cooperation with the competent UN structures in regard to their methodological assistance in development and expert examination of the national strategies;
- c) provide for cooperation between national ESCs in the field of human capital enhancement and methods of its evaluation embracing specific national, social, and cultural features of various countries;
- d) launch a dialogue on the means to reduce the negative impact of the existing international system of human capital exchange on the developing countries.

48- Since social engagement is a very specific matter for the ESCs participating in AICESIS, it would be of interest to delve deeper into this matter, analysing specific actions taken by ESCs. A large proportion of actions to improve human capital and thus improve competitiveness could be taken within specific areas of action of social partners – vocational training and on-going training, human resources management within companies and other activities.