

# A critical examination of the concept of “human capital”

## The perspective of Islamic economic jurisprudence

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### I. Introduction

The term “capital” had been existed long before capitalism, but it was exposed to a major transformation by the emergence of it because, as the engine of capitalism, industrialization changed the way that economists evaluated and defined economic development, as well as the concepts attached to it. In this way, the meaning of capital shifted from “monetary finance” to the “means of production.” In time, its meaning widened even further and started to include “anything which is helpful to produce economic value.” Today, the concept of capital also includes neo-capital concepts, such as human capital, which have been encountered more often since the 1960s. In general, what is meant by human capital is any attribute pertaining to human beings in producing economic value.

Islam is a religion that provides a worldview that is compatible with the divine. Such a view includes, among other things, how to evaluate and conduct economic affairs, how to build economic relations, and so on. This was also the starting point of the twentieth-century discipline of Islamic economics.<sup>29</sup> Despite there still being no consensus regarding its definition, here we would like to share the following definition of Asad Zaman (2013): “Islamic economics is the *effort/struggle*<sup>30</sup> to implement the orders of Allah pertaining to economic affairs in our individual lives (micro), in our communities (meso), and at the level of Ummah (macro).” This definition underlines the importance of the three main levels at which Islamic economics can be applied. It can be added here that the cornerstones of Islamic economics are Islamic jurisprudence and Islamic ethics.

By taking into account all of the above, the aim of this paper is to critically examine the concept of human capital. In this context, we utilize in particular the perspective of Islamic economic jurisprudence.

With respect to the methodology of this study, we follow a critical approach against a common methodology followed in Islamic economics. Today, it is a common practice in studies related to Islamic economics to take the modern concept of mainstream economics without evaluating its peculiarities and considering whether it can fit into the general framework of Islamic perspective, then attempting (even pushing) to find a corresponding concept in Islamic literature. Details of our methodology in contrast to this will be explained below.

The main importance of the subject comes from the fact that human capital is connected to some other concepts, such as the means of production. Thus, a better understanding of human capital can help us to understand the related concepts and relations built around these concepts.

The structure of the paper is as follows. The next section will clarify the methodology of this work. The third section will give background information and set out a literature review. The fourth section will be an evaluation. The fifth and last section will conclude the paper.

## 2. Methodology

It was mentioned above that our methodology is based upon a critical approach. In contrast to the aforementioned methodology followed in current studies within Islamic economics, first, we do not take the concept of human capital as given. Instead, by critically analyzing its development, we show that this concept is not a new invention but has since the very early times been already known and taken into account. At this point, a question emerges: “then, why was such a concept developed?” In the second step of our critical approach, we show that this concept was developed because of the transformation of the Western world’s mind-set, which started with modernization.

These two steps do not lead us to attempt (even to push) to find a corresponding concept in Islamic literature. Instead, they lead us to a more critical search of the concept or its meaning in the literature. Thus, the third and main step of the methodology of this study depends on an examination of the concept of human capital, or, more correctly, what it refers to in Islamic economic jurisprudence. The reason why we wrote “what it refers to” is because, while the concept is new, the classic Islamic literature is not. With respect to this third step, we take into account two aspects of economic relations and issues: contract conditions and the source of value.

## 3. Background information and literature review

In this section, we will first concentrate on the development of the concept of human capital in mainstream economics. Then we will focus on the labor–capital relationship and the concept of human capital in Islamic literature.

### 3.1. Development of the concept of “human capital” in mainstream economics

Despite the term not being used directly in his work, the first reference to human capital is generally attributed to Adam Smith. This attribution is not out of place since in his book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Smith (2005, 1776) explains that fixed capital at the national level consists of all useful machines and instruments of trade, of all profitable buildings, of the improvements of land, and of *the acquired and useful abilities of all the inhabitants and members of the society*.<sup>31</sup>

While investigating the historical roots of the concept of human capital, Kiker (1966) mentions some names who considered human beings and/or their skills to be capital. Adam Smith is included among those names, but another name mentioned by Kiker is Irving Fisher. Hodgson (2014) notes that the first official appearance of the term “human capital” was in an article by Fisher. In fact, Fisher (1897) writes that “The most natural classification of capital in its first sense is into human capital, land capital, and what for want of a better name we may call products.”

Accordingly, whether we take the indirect use of the concept in 1776 or the first direct use of it in 1879, we can easily say that human capital is a modern concept. However, even though

the term did not exist before that, its inherent meaning has long existed in human life. At this point, we first need to clarify the inherent meaning of human capital. As was explained in the introduction, in a general sense, what is meant by human capital is any attribute pertaining to human beings in producing economic value. The attributes in question can be an ability, a talent, intellect, wisdom, and so on. Here, we need to ask; “were not these and similar attributes taken into account in earlier times?” The answer is yes.

Then, if the importance of human attributes has been well-known and appreciated since ancient times, why was an independent concept needed? This is an important question to be answered. In fact, this has a lot to do with modernization and its effects on minds and points of view, because, first and foremost, a major change occurred regarding the understanding and evaluation of capital.<sup>32</sup> The concept of capital, from which human capital is derived, had been used in a monetary sense before industrialization. Its meaning then shifted toward the means of production. In the neoclassical era, the meaning of capital focused on physical capital. Today, the borders of capital have extended even further with the inclusion of neo-capital concepts such as human capital, social capital, and so on. For the transformation of the meaning of capital, see Cannan (1921) and Hodgson (2014). Despite its long journey, there is still no consensus regarding what is meant by the concept of capital. Conversely, the transformation of the meaning of capital has been accompanied by serious problems. Three main problems in this regard are: the confusion of interest with profit – especially because of the marginalist approach; the problem of measurement; and problems related to the inclusion of neo-capital concepts. This last problem will be explained in detail below.

Second, an intense desire for measurement and quantification appeared with industrialization. There has also been a similar impetus behind the development of the concept of human capital, i.e. the measurement of the effect of the human attributes. Regarding this, Kiker (1966) explains two methods that have been used to estimate the value of human beings: the cost of production and the capitalized earnings procedures. Kiker continues by explaining that one of the first attempts to estimate the monetary value of human beings was made around 1691 by Sir William Petty. However, the first scientific study in the subject was by William Farr in 1853. On the other hand, Ernst Engel preferred a cost of production procedure around 1883. In addition, Dublin and Lotka made calculations of human values in 1930. Kiker argues that the works of Farr and Dublin and Lotka should be the starting points for anyone who is interested in estimating either human capital values or their components. It is no surprise that the early quantification attempts corresponded to the early period of industrialization. It is also interesting to note that both Petty and Farr are from England, the birthplace of industrialization. From a wider perspective, van Leeuwen (2007) states that “The notion of human capital arose out of the awareness that physical capital alone was not enough to explain long run growth.” This is why empirical studies have been dedicated to measure the effect of human capital on growth. However, this does not mean that the quantification of human capital can be achieved without issues. The problems in that regard will be explained below.

The concept of human capital became more prevalent with the work of Schultz (1961). Schultz starts his famous article by explaining the reasons why people were shying away from considering human capital as capital. According to Schultz (*ibid.*), “The mere thought of investment in human beings is offensive to some among us. Our values and beliefs inhibit us from looking upon human beings as capital goods, except in slavery, and this we abhor.” Schultz confirms that human resources have both quantitative and qualitative dimensions. In that regard, the practice of estimating the magnitude of capital formation by the expenditure made to produce capital goods also suffices for the formation of human capital. However,

differently from physical capital, there is difficulty in distinguishing between expenditure for consumption and for investment.

Even though there is no consensus regarding the definition of human capital, the following quotation can give us a clue about the point which the concept has reached today. According to an OECD Report (2001), human capital is “[t]he knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being.”

If we take the 1960s as the beginning of the development of the concept of human capital in the modern context, it should be said that this half-century of development has not been without problems and criticism. We can categorize the main problems and criticisms related to the concept of human capital as follows: (i) the measurement problem; (ii) the noncollateralization problem; and (iii) criticism from a Marxian perspective. In relation to the first issue, van Leeuwen (2007) explains that, “even when a narrow definition of human capital is used, calculating a human capital stock series in monetary terms is very data-and-time-intensive.” He explains that this is why using educational stock as a proxy is popular. But this is not immune from problems either. For instance, enrolment ratios are flow, not stock. Besides educational stock, there are income-based and cost-based approaches. However, as argued by van Leeuwen, these methods create difficulties if they are intended to be put into growth regressions. It should be added here that, even if human capital can be measured despite all these difficulties, the bigger problem of valuing it remains.

In terms of the second problem, Hodgson (2014) argues that “the capitalist can borrow money on the basis of the collateral in her owned factories or machines, but the worker has no such collateral.” Thus, Hodgson (*ibid.*) suggests with sarcasm that “[i]f we can have human capital, then we have to find another word to describe collateralisable capital.”

Regarding the third issue, Bowles and Gintis (1975) argue that “[t]he theory of human capital, like the rest of neo-classical economics, ultimately locates the sources of human happiness and misery in an interaction of human nature with nature itself. This framework provides an elegant apology for almost any pattern of oppression or inequality.”

In sum, human beings’ attributes have been taken into account and appreciated since early times. In that sense, the concept of human capital is nothing new. What is new is the transformed mind-set of modern people regarding economic concepts. Furthermore, the desire of modern people in measuring the quantified effect of everything in value creation is also new. In this context, the concept of human capital was generated because the understanding of capital was transformed by industrialization, and also because of the emergence of the desire for measuring each and every factor of growth. However, as explained above, this does not mean that this newly generated concept is free from problems.

### **3.2. Labor–capital relations and the human capital concept in Islamic literature**

As was explained in the previous subsection, human capital, as a concept if not a term, was known in earlier times. This was also valid for Muslim communities. At that time, human beings’ attributes were implicit in labor. We can give the following Hadith example in that regard:

1. Narrated Aisha: Allah’s Apostle and Abu Bakr hired a man from the tribe of Bani–Ad–Dil as an expert guide who was a pagan (follower of the religion of the pagans of Quraish). (Sahih al-Bukhari, vol. 3, Book 36, 465)

It can be seen from the Hadith that a person was hired especially because of his expertise. One can also visit the labor–capital partnerships in Islamic history in which labor can attract higher profit sharing ratios depending on his/her attributes. Furthermore, at earlier times, labor was accepted to be the main source of value, whereas capital was seen as derivative of it. This is also what has changed with modernization: capital started to be seen as the basic source of value.

In Islamic literature, the focus on labor dates back to the Middle Ages. It is commonly argued that Ibn Khaldun (1332–1406) is the first scholar in the history of economic thought who stated labor to be the main source of value. In his famous book *Muqaddimah*, Ibn Khaldun (1375) writes that “labor is the real basis of profit.” Such a description implies that differences pertaining to labor arising from different human attributes cause different profits. In relation between labor and capital, Ibn Khaldun (*ibid.*) writes that

the capital a person earns and acquires, if resulting from a craft, is the value realized from his labor. This is the meaning of “acquired [capital].” There is nothing here [originally] except the labor, and [the labor] is not desired by itself as acquired [capital, but the value realized from it].

(*ibid.*)

The focus on labor in Islamic literature continued after Ibn Khaldun. One can see Azid’s survey (2005) regarding the concept and nature of labor throughout Islamic history. However, Islamic studies discussing the nature, properties, and calculations of labor needed to wait until the second half of the twentieth century to flourish. This was also the period of the establishment of Islamic economics as a separate field of research. The reasons for such a phenomenon need further investigation but, based on the above explanations, it can be said that there was no endogenous transformation related to the meaning of capital within Islamic economic history. As comparison of the understandings of the concept of capital, Sadeq (1989) argues that “a fixed return on capital is not allowed in Islam, but a fixed return on a building (rent) is allowed and, therefore, building cannot be termed as capital.” Furthermore, Sadeq argues that, unlike mainstream economics, produced means of production cannot be accepted as capital from an Islamic perspective. It should be noted that changes in understandings of the concept of capital and how it is evaluated in today’s world from an Islamic perspective need detailed research.

Works in Islamic economics which deal directly with the concept of human capital have started to take place more frequently over around the last decade. Many works related to human capital in Islamic economics underline its importance due to its potential impact, as works in mainstream economics usually do. In that regard, Thaib (2013) and Yusoff (2011) mention the potential effect of human capital on a country’s development.

As another group of works, we can see that there has been an attempt to combine Islamic aspects and the human capital concept. In this context, Rafiki *et al.* (2014) define “Islamic human capital” in a way that encompasses the aspects of both worldly life and the hereafter, and which instructs Muslims to seek not only profit maximization but also *maslahah* (the public interest). Abu Samah *et al.* (2011) discuss the contribution of the management practices and skills of the Prophet Muhammad (pbuh) for human capital development. Hashi and Bashiir (2009) explain that, while conventional theories of human capital development take human life as an ascending process with continuous transformation and change, the “*tawhidic* conception of Islam” is based on metaphysical principles and ethical values.

For a last group of works, we can mention alternatives. In his study, Choudhury (2012) prefers to use human *potential* instead of human *capital*. This is not only a matter of conceptualization; it is deeper than that because, according to him, old mainstream postulates such as optimality, steady-state equilibrium, predictability, and the permanence of economic rationality are inherent in the human capital concept. Thus, it cannot fit into the phenomenology of the evolutionary learning model of Islam. As a more theoretical criticism, Zaman (2009) argues that the

[u]se of the terms “human capital”, human resource development and development of job skills and productivity as a means of progress highlights the currently dominant view of humans as an input to the production process. This contrasts with the Islamic view that the development of human beings is the goal whereas the production resources, etc. is only useful to the extent that it is a means to this goal.

In sum, human attributes which contribute production and value creation have all long been known and appreciated by Muslim communities. All of these attributes were taken as inherent in labor. This phenomenon is also connected with the great importance bestowed upon labor. Therefore, it is no surprise that labor was named the main source of value at an early time, around the fourteenth century. Since both the effect of industrialization on understanding the concept of capital and the desire for quantification came much later (and also not in the same level and manner) to Muslim communities, detailed investigation regarding labor and the development of a separate term for human capital had to wait until the birth of the modern discipline of Islamic economics in the twentieth century. Works related to human capital have been more visible within the field, especially over the last two decades. Some of these works attempt to combine Islamic aspects with human capital, while the main body of works either takes the term as given and attempts to find a correspondence to it from within Islamic literature or takes the importance of the term due to its potentiality. There is also a scarcity of work that attempts to provide a critical, alternative point of view.

#### 4. Evaluation

In this section, we will investigate the concept of human capital from the perspective of Islamic economic jurisprudence. In that regard, there are two important points that can guide us. The first point is, in a way that is distinct from the potentiality aspect of human capital, labor is related to finality. This is why labor, not human capital, is the issue in Islamic economic jurisprudence, because only labor can be the subject of a contract. We can mention the following Hadiths in that regard.

- i) Malik said, “If any of that enters the *qirad* [capital–labor partnership], it becomes hire, and hire is only good with known and fixed terms” (Malik 2005, Muwatta, Book 32, Hadith 6).
- ii) It is not permitted for an investor to stipulate to an agent (in *qirad*) to only buy from a specific person. That is not permitted because in doing so he would become his employee for a wage. (Malik 2005, Muwatta, Book 32, Hadith 6)

These two Hadiths show that labor can be the subject of two types of contracts: partnership and hiring on contracts based on known and fixed terms. By “known and fixed terms,” we

mean aspects such as well-defined tasks, times and salaries. For partnership contracts, it has been said before that labor can get higher sharing ratios in consequence of his/her attributes. In either case, while a human being can have *potentiality* depending on his/her educational background and so on, as long as this person does not actualize this potentiality it would not be reflected in the final result, whether that is salary or profit. In other words, this person's potentiality is taken into account only insofar as it is the fulfillment of the contract conditions. Thus, human capital can never be a contract subject.

The second point is related to sources of value. For instance, when the economic value of profit is created as a result of a partnership agreement, for Hanafis and Hanbalis, the right to profit arises because of three things: capital, work, and *daman* (liability). The work here is that which is contracted for labor. Thus, there is a direct connection between value creation and labor. However, there is only an indirect connection between human capital and value creation since human capital is in *potential* form. In relation to this point, Imam Muslim writes the following in the Introduction to the *Transactions of Sahih Muslim* (n.d., 2000): "it is not only the capital invested that brings profit which is equally the result of initiative, enterprise and efficiency of the entrepreneur . . . A person reaps a benefit after undergoing labour and hardship." It can be noticed that he mentions human attributes like initiative, enterprise, and efficiency under the label of labor. In respect to this second point, one can also turn to Ibn Khaldun, whose relevant ideas were explained above.

Ultimately, labor, including human attributes instead of a concept like human capital, is the subject matter of Islamic economic jurisprudence for two basic reasons: only the former can be the subject of a contract, whether it is hiring or partnership, and, second, there is a direct connection between labor and value but not between human capital and value. Both of these reasons depend on the potentiality aspect of human capital. This is probably also the reason why Choudhury calls his alternative human capital concept "human potential." Thus, the perspective of Islamic economic jurisprudence is quite strict and well defined in that regard. This is also why concepts such as intellectual capital cannot be based upon Islamic jurisprudence. Only with the birth of Islamic economics could the issue of human attributes as separate notions under the label of human capital or alternative descriptions be evaluated separately from the jurisprudential perspective.

## 5. Conclusion

In this article, we attempted to examine the concept of human capital critically. In doing this, we first argued that, despite what it refers to being understood well before modern times, the concept of human capital was developed for two basic reasons: conceptual and mental transformation and the urge for quantification. Both of these reasons have close connections with industrialization, which started in the Western world. The point here is not to discuss the legitimacy of each and every concept developed in the West but to show the massive impact of modernization and how it created a sharp disengagement from earlier times, although such an impact and disengagement are not always positive, as in the case of the concept of human capital, because of some problems listed and explained throughout the paper.

Then, in continuation of our critical approach, we examined the concept from the perspective of Islamic economic jurisprudence. We concluded that labor, including human attributes, rather than a concept like human capital is the subject matter of Islamic economic jurisprudence for two basic reasons: only labor can be the subject of a contract, whether it is a hiring

or partnership contract; and a direct link only exists between labor and value, not between human capital and value. We also underlined that both of these reasons are closely related to the potentiality aspect inherent in the concept of human capital.

We also argued that only with the birth of Islamic economics in the twentieth century could the issue of human attributes as separate notions under the label of human capital or alternative descriptions be evaluated separately from the jurisprudential perspective. We supported this with relevant works from within the literature of Islamic economics.

It should be noted here that this paper did not aim to redefine an alternative concept, since such an aim needs to transcend the borders of Islamic economic jurisprudence and take different aspects of Islam (such as morality) and economics (such as theory of value) into consideration. We would like to mention that Choudhury's attempt (2012) is noteworthy in that regard.

## Notes

- 29 Here we will not go into detail regarding the discussions of whether economics can be described as Islamic or whether, indeed, an Islamic economics is possible. Furthermore, the reasons of why this discipline emerged as late as the twentieth century necessitate separate research. For further reading on the history of Islamic thought in economics, and on Islamic economics, see El-Ashker and Wilson (2006).
- 30 The italicized words belong to Zaman himself.
- 31 Italics belong to us and represent the implication of human capital.
- 32 It is difficult to say whether changes in points of view regarding capital paved the way for modernization or vice versa. Maybe it is more correct to say that both are valid.

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