

Explaining income differentials

-- a comparison between human and social capital approaches

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There are two main theoretical perspectives that compete in accounting for income differentials in the labour market. Economists and human resource experts tend to favour the 'human capital' approach, stressing the role of education, experience, job-related skills and training, and language fluency (Mincer, 1974; Borjas, 1992, 1995). Sociologists tend to adopt the 'social capital' approach, emphasizing the benefits gained from formal and informal social networks in job searching, and from social interactions in general that engenders in the networked a trustworthiness which is deemed of great importance both in gaining access to the labour market initially and in gaining promotions in subsequent careers (Granovetter, 1973, 1974; Lin et al, 1981; Lin, 2001; Bourdieu, 1985; Portes, 1998; Putnam, 2000; Peterson et al, 2000). It is, however, worth noting that while the economists have conducted considerable research into the role of 'human capital' as they define it on income differentials, sociologists or social capital researchers have not made comparable progress. The reason is that the human capital indicators as defined by economists are more easily available in survey data than social capital indicators.

There are two main traditions of social capital conceptualization. The first is the network approach in the sense of the theses of the strengths of strong or weak ties. Such data are rarely available in nationally representative samples. A new version of that in the form of Position Generator is also imperfectly designed to be of direct use. The second tradition is the Putnam notion comprising civic engagement and informal social connections. While the former aspect is increasingly used in social surveys, the latter is hard to explore in survey terms. It is very difficult to get a dataset that contains all these essential elements for a comparative study of the effects of human versus social capital on income differentials at a given time and income changes between different time points.

In this presentation, I intend to do just that. I will use the BHPS to try to compare the effects of human and social capital on income differentials and income changes. The variables as indicators of the two kinds of capital are constructed from the dataset in a way that is both theoretically meaningful and methodologically the best available. For human capital, in addition to educational qualifications, I include whether people are foreign or UK born, and years of residence in the UK for those who were foreign born: these, together with age (and age squared), serve as indicators of knowledge and experience of experience about and knowledge of the (local) labour market. In explaining income changes, I also include attendance of full time education between waves 7 and 11, as indicating investment in human capital. For social capital, I use item response theory models to construct the latent factor scores for categorical component variables and derive three dimensions of social capital: neighbourhood attachment, social networks and civic engagement. For income changes, I also use information between waves 7 and 11 on 'whether there is someone outside your

household who can help find a job for you'. Social class is included as an indicator of social capital, as economists usually have no strong inclination to use this variable as an indicator of human capital.

The results show that, for income differences at wave 7

- Effects of demographic attributes as expected
- No obvious ethnic penalties controlling for other factors in the model
- Human capital, especially as indicated by higher educational qualifications, is highly important, controlling for demographic factors
- Social capital, especially as indicated by class, plays an even more important role than human capital, but bonding capital has a negative and bridging capital positive role, controlling for personal characteristics
- Social capital relatively more important than human capital when directly compared

And with regard to income changes between wave 7 and wave 11,

- Blacks and Pakistanis/Bangladeshis were making notable improvements in their earnings in the five years
- The effects of demographic, human and social capital in this regard are similar in pattern to that in income differentials at wave 7
- Additional indicators for human capital (attending full time educational institutions) and for social capital (having people outside the household help find a job) are both significantly related to higher earnings, holding constant all other factors in the models
- Again there is evidence of more notable effects of social than human capital effects, but bonding social capital has a negative effect

My other writings on social capital:

- Li, Y. and Savage, M. (2005) 'Civic engagement and social networks as bridging social capital for the working class', mimeo, Birmingham University.
- Li, Y. (2005) 'Social capital, ethnicity and the labour market', *Proceedings of International Conference on Engaging Community*, conference jointly organized by the United Nations and the Government of the State of Queensland in Australia (conference 14-17, Aug. 2005). www.engagingcommunities2005.org
- Li, Y., Pickles, A. and Savage, M. (2005) 'Social Capital and Social Trust in Britain', *European Sociological Review*, 21(2): 109-23.
- Li, Y., Savage, M. and Pickles, A. (2003) 'Social Capital and Social Exclusion in England and Wales (1972-1999)', *British Journal of Sociology*, 54(4): 497-526.
- Li, Y., Savage, M. and Pickles, A. (2003) 'Social Change, Friendship and Civic Participation', *Sociology Research Online*
- Li, Y., Savage, M., Tampubolon, G., Warde, A. and Tomlinson, M. (2002) 'Dynamics of social capital: trends and turnover in associational membership in England and Wales: 1972-1999', *Sociological Research Online*, Vol. 7, No. 3.