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Part I

Theory and Research

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1

Theories of Capital

The Historical Foundation

One of the far-reaching explanatory schemes in contemporary sociology and economics focuses on the concept of capital. What is *capital*? I define it as *investment of resources with expected returns in the marketplace*. Capital is resources when these resources are invested and mobilized in pursuit of a profit – as a goal in action. Thus, capital is resources twice processed. In the first process, resources are being produced or altered as investment; in the second, the produced or altered resources are being offered in the marketplace for a profit. In one instance, capital is the outcome of a production process (producing or adding value to a resource); in the other, it is the causal factor in a production (the resource is exchanged to generate a profit). These are processes because both investment and mobilization involve time and effort. In the past two decades, social capital in its various forms and contexts has emerged as one of the most salient forms of capital. While much excitement has been generated, divergent views, perspectives, and expectations have also raised a serious question: is this a fad, or does it have enduring qualities that will herald a new intellectual enterprise?

The purpose of this volume is to present a theory of social capital, a theory eliciting the central theme that capital is captured in social relations and that its capture evokes structural constraints and opportunities as well as actions and choices on the part of the actors. Firmly anchored in the general theory of capital, this theory will, it is hoped, contribute to an understanding of capitalization processes explicitly engaging hierarchical structures, social networks, and actors. This theory, and its research enterprise, argue that social capital is best understood by examining the mechanisms and processes by which embedded resources in social networks are captured as investment. It is these mechanisms and processes that help bridge the conceptual gap in the understanding of the macro–micro linkage between structure and individuals.

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This chapter will explore the nature of capital and various theories of capital, a context essential in leading up to the presentation and analysis of social capital, which begins in the next chapter.

The Classic Theory: The Marxian View of Capital

To understand social capital, we must first clarify the notion of capital. The notion of capital can be traced to Marx (1849, 1865/1933/1935, 1867/1995; Brewer 1984) in his analysis of how capital emerges from social relations between the bourgeoisie (capitalists) and laborers in the processes of commodity production and consumption. Marx saw capital as part of the surplus value (created through the processes of commodities production and exchange) that creates further profit (Marx 1867/1995, Vol. 1, Chap. 4, and Vol. 2, Chap. 1). The production of commodities engages labor, land, rents, and materials (including facilities, technology, and transportation). Each of these elements incurs a use (or production) value for the producer. However, while a laborer is paid a fixed weekly or monthly wage, the laborer puts out more than the necessary number of hours in producing the commodity (socially necessary labor), and the produced commodity thus carries a lower cost of labor for the producer. That is, the generated use value surpasses the exchange value in payment to support the laborer's subsistence. Thus, a surplus value (or profit) results. Further, the producer (or rather the capitalist) then engages in an exchange process in which the produced commodity is exchanged for another commodity (in the modern world, usually a medium of commodities, i.e., money). The field of exchanges may engage the producer and the consumer either directly or through intermediaries such as traders and merchants. The commodity generates a market value in these exchanges. If the market value exceeds the use (production) value or cost, then further surplus value, or capital, results from the exchange. Figure 1.1 depicts my rendition of Marx's notions of how capital emerges from social relations between capitalists and laborers in the processes of commodity production and consumption.

The processes begin with the capitalist, who is bestowed with resources (capital) to begin with (e.g., land ownership, aristocracy inheritance) and who engage in commodity production by establishing an exchange relation with laborers, who contribute their labor in the production process. In return, the capitalist assesses the value of the commodity produced and pays the laborers in accordance with this value (known as the *exchange value*), usually in money. As presented in Figure 1.1, this relationship is represented by the production exchange between a capitalist and a laborer in the production of Commodity 1.

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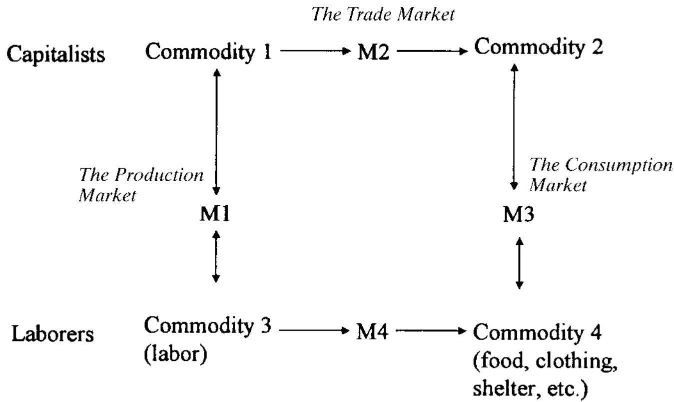

Figure 1.1 Rendition of Marx's thesis on production and consumption relations.

Commodity 1 is the outcome of the production, and Commodity 3 is the labor contributed by the laborer. M1 represents the payment of the capitalist to the laborer for the work performed (Commodity 3) on the production of Commodity 1. The exchange value represents the "socially necessary value" for the production, or what is deemed necessary to pay the laborer for the labor performed (Commodity 3).

The produced commodity (Commodity 1) is then moved through a trade market (from Commodity 1 to Commodity 2) and to the consumption market (from Commodity 2 to Commodity 3). Thus, in the simplest process, Commodity 1 is directly offered as Commodity 2 by the producers to the consumers. The consumers, to a large extent, are the laborers who use the money earned in the production process (M1) to purchase the essential commodities (Commodity 4) for survival. They pay a price (M3) to get these commodities. Marx presents the following arguments:

1. M1 is essentially the same as M4 in value. That is, the payment for labor received by the laborer is the same value that the laborer uses to purchase essential commodities for survival. It is the exchange value, representing no gain or loss of value.
2. M2 is greater than M1 and/or M3 is greater than M1. That is, the selling value of the commodity in the trade and consumption markets is greater than its production value.

Thus, these two processes, the production process and the trade/consumption process, result in two important and separate consequences for laborers and capitalists. Laborers earn the value for their labor

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(Commodity 3), which is in turn exchanged to get the essential goods (Commodity 4) for survival, and they earn no surplus value in the process (M1 = M4). Capitalists gain a surplus value (M3 – M1), part of which becomes capital.[1] Thus, the circulation of commodities sustains laborers' subsistence so that they can continuously provide the commodity (labor) necessary in the production process, but no more. On the other hand, the capitalists gain surplus value from the circulation of commodities, of which a significant portion can become capital. The processes are usually more complex, of course. For example, the capitalists can trade the produced commodities among themselves or to other capitalists, from Commodity 1 to Commodity 2, and gain a surplus value (M2 > M1). These other capitalists (traders, merchants) create their own surplus values by circulating the commodities to the consumption market (M3 > M2). Thus, there are capitalists other than those directly engaged in production within the circulation system (the nodes along the circulation of commodities or the chains in the forms of C-M-C and M-C-M, such as traders, merchants, etc.). Capitalists are the ones who get to keep the capital, usually in the form of money.

This system of commodity circulations and social relations between capitalists and laborers sustains itself so long as (1) M1 is kept at a minimum (socially necessary value) and is always nearly equal to M4 and (2) M3 is always greater than M1 (or M2 > M1 and M3 > M2), so that the surplus value (and capital) is generated. When this system is sustained, there is assumed to be no mobility from laborers to capitalists, since, first of all, the capitalists control the means of production (assembling materials, instruments, and labor) and, second, the laborers will never accumulate capital and the capitalists will continue to accumulate capital. Thus, capital is a return (of surplus value) on an investment in the production of useful commodities in the marketplace. Capital can appear in the forms of money, the capacity to control the means of production, and/or further investment to produce more useful commodities. When the focus is on the process of producing surplus value, *capital may be defined as an investment with expected returns in the marketplace*.

In summary, then, in Marx's analysis, capital is part of the surplus value captured by capitalists or the bourgeoisie, who control production means in the circulation of commodities and monies between the production and consumption processes. In this scheme of a capitalist society, capital represents two related but distinct elements. On the one hand, it

[1] Surplus value has two components: revenue (part of which will be used for the repeated production processes and part of which will be used to sustain luxury-leisure or lifestyle expenditures) and capital (an increment of the valued resources).

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is part of the *surplus value* generated and pocketed by the capitalists (and their "misers," presumably the traders and sellers). On the other hand, it represents an *investment* (in the production and circulation of commodities) on the part of the capitalists, with expected returns in the marketplace. Capital, as part of the surplus value, is a product of a process; capital is also an investment process in which the surplus value is produced and captured. It is also understood that the investment and its produced surplus value refer to a return/reproduction of the process of investment and of more surplus values. It is the dominant class that makes investments and captures the surplus value. Thus, Marx's theory is a theory based on the exploitive social relations between two classes.

Central to this theory are several important notions concerning capital. First, capital is intimately associated with the production and exchange of commodities. Commodities, in the theory of Marx, are mainly material goods that carry price tags in both the production and exchange processes. Labor, labor power, and labor value are part of the price tag and are seen as "socially necessary" in the production of a commodity. But it is commodities, through their production and exchange, that generate capital. Labor is a necessary factor in the process of producing a commodity, but it is subservient to the commodity itself.

Second, capital involves processes rather than simply a commodity or value, even though it may be the final result. Capital represents an investment process on the part of the capitalist, as production requires assembling and organizing labor, land/rents, equipment, facilities, and so on. These entail investment of initial capital, effort, and social activities of coordination and persuasion. When the processed commodity is exchanged for a profit, it also entails a process in the marketplace.

Third, as a result of these processes, any resultant capital is an added value (surplus value or profit). The existence of capital means that the market value of a commodity exceeds its production value or cost to produce. If the market value is the same as or less than the cost, there will be no capital from the commodity, and in fact there may be a deficit or debt.

Fourth, capital is intrinsically a social notion. Capital entails processes of social activity. The production process, as mentioned, involves social activities. For example, Marx explicitly describes use value as dependent on "socially necessary labor," since there is no objective value or worth that can be used to calculate the value or cost of labor. The exchange process, by definition, is also social.

Fifth, capital is captured by the capitalist or producer from the circulation of commodities through the cycle of commodity production and exchange and capital accumulation. Capital is a process and an end result

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that lies by definition in the hands of those who control the means of production. The means of production create and accumulate in the form of capital. Capital, in turn, consolidates control over production means (e.g., circulation of commodities and circulation of capital; see Marx 1867/1995, Vol. 1, Chaps. 3–5). In Marx's formulation, laborers are paid wages to meet their subsistence needs, and no more. In other words, capital is the surplus value generated from the capitalist's investment in the production and is captured by the capitalist.

I will call the notion of capital and its features as described by Marx the *classic theory* of *capital*. The basic idea that capital is the investment of resources for the production of profit has been maintained in all subsequent capital theories. However, in the Marxian scheme, both investment and profit are vested in the capitalists. The labor involved in the process of production does not generate or accumulate capital for the laborers. The classic theory of capital is based on the explanatory argument that class differentiation is fundamental in capitalist society, where the exploiting class controls the means of production and collects all the surplus value generated from the labor provided by the exploited class. The evolution of capital theory in the last four decades into what can be called *neo-capital theory* essentially modifies or eliminates the class explanation as a necessary and required theoretical orientation. These alternative renditions of capital notably include human capital, cultural capital, and social capital.

Neo-Capital Theory: Human Capital

Human capital, which assumes that capital can rest with the individual laborer, can be traced to Adam Smith, who included all the acquired and useful abilities of the population in a country as part of capital (1937). In the late nineteenth and early twentieth centuries, this notion occasionally surfaced in the economic literature (von Thunen 1875; Fisher 1906). Contemporary understanding of human capital can be attributed to the works of Johnson, Schultz, and Becker (Johnson 1960; Schultz 1961; Becker 1964/1993). Johnson (1960) argued that laborers have become capitalists, not from a diffusion of the ownership of corporation stocks, as capitalist public relations would have it, but from the acquisition of knowledge and skills that have economic value. That is, with knowledge and skill, the laborers can demand from the capitalists payment beyond the exchange value for their labor. Presumably, their knowledge and skills enable the hourly worth of their labor to exceed that of others who do not have such knowledge and skills.

However, the first systematic presentation of the human capital argu-

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ment was made by Theodore W. Schultz in his presidential address at the 1960 meeting of the American Economic Association (1961). In this seminal piece, "Investment in Human Capital," he forcefully condemned "the failure to treat human resources explicitly as a form of capital, as a produced means of production, [and] as the product of investment, [which] has fostered the retention of the classical notion of labor as [only] a capacity to do manual work requiring little knowledge and skill, a capacity with which, according to this notion, [all] laborers are endowed about equally" (p. 3). In addition, Becker (1964) explicated human capital most forcefully in terms of education, but later also in terms of a host of other factors.[2]

Schultz's challenge and proposal formed the basis of the human capital theory, elaborated by other economists, Becker (1964) being the principal one among them. Human capital, unlike physical capital, is the value added to a laborer when the laborer acquires knowledge, skills, and other assets useful to the employer or firm in the production and exchange processes. The important distinction between physical and human capital is that human capital is the added value embedded in the laborers themselves. Typically, human capital is operationalized and measured by education, training, and experience. Investment in human capital on the part of laborers is good not only for the firm/producer, but also for the laborers themselves. Human capital adds the value of the labor, and part of the value can be negotiated and retained by the laborers as wages and benefits, beyond the minimal amount required for subsistence needs.

Thus conceived, human capital may be seen as any investment on the part of the laborers that will result in increased worth (M1) in commodity production process. This value affords three types of expenditures, according to Schultz: expenditures for (1) consumption, (2) investment (human capital), and (3) both consumption and investment. Because of the difficulty of disentangling the third type of expenditure from the first two (i.e., decomposition of M4 in terms of these three expenditures), Schultz proposed that the effects of human capital should be estimated by its yield rather than its cost; "the resulting increase in earnings is the yield on the investment" (p. 8). In essence, for human capital, there is no substantial change in the definition of capital relative to the Marxian notion. It remains an investment with an expected return in the marketplace. From the Marxian point of view, this added value

[2] For example, Schultz also proposed that not only skill and knowledge acquisition but also health and migration would yield additional economic value. Becker added a host of other factors. There is a danger, however, of including all things that sustain or improve life itself as human capital. I choose to focus on the original intent.

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(knowledge, skills) enables the capitalist (the employer or firm) to increase the capacity of labor (e.g., labor power; Marx 1867/95, Vol. 1, Chap. 6). As a result, the market value of the commodity or production is increased (either in quality, quantity, or both). So long as the increased wage for such added capacity grows at a lower rate than the use value from the capacity generated, profit will increase, adding to the capital of the capitalist. Thus, human capital can be seen as consistent with the theoretical scope of Marxian analysis: capital is viewed from the capitalist's, producer's, employer's, or firm's perspective in the production and exchange of commodities.

However, the classical capital theory received a major challenge: that the immobility of class distinctions between the capitalists and the laborers no longer holds. If laborers can acquire skill, knowledge, and other capital to increase the value of their hourly labor, two things can happen:

1. M1 may no longer be mere exchange value for the laborers. Payment for skilled labor may exceed the socially necessary value of the labor without required skill. Rather than acting as replaceable commodities on the assembly line, certain laborers can now claim and charge higher value for their labor because, for the same labor unit (hour), more production may be accomplished. Thus, M1 contains use value for the laborers and capitalists alike.
2. M1 is no longer equal to M4 – the earnings necessary to sustain lives. Instead, M1 is greater than M4. There is a surplus value of labor for laborers with capital. That is, after expenditures for essential commodities for survival (Commodity 4), there is a residual value that can be used as (1) revenue, which can be used to invest in capital-generating activities or to support leisure and lifestyle needs, and (2) capital (e.g., accumulation of money and other valued resources).

Thus, while the human capital theory does not deviate substantively from the classical (Marxian) theory in the definition of capital, it challenges the classical theory regarding who can or cannot acquire capital. The vision of the social structure is altered. Everyone can invest and acquire capital. Far from being a homogeneous society, there are different opportunities or motivations in the acquisition or nonacquisition of human capital, so that the worth of labor as a commodity varies across individuals. Nevertheless, the social structure is now envisioned as a hierarchy of many grades of capitalists, with extensive cross-grade mobility possible, rather than a rigid two-class system.

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This alternative view challenges the classic theory of capital in its fundamental stance: that in the capitalist state the capitalist, as controller of resources for production, extracts capital from low-skilled and interchangeable laborers. By arguing that laborers themselves can accumulate capital by investing in skills and knowledge that are economically productive, Schultz and Johnson turn laborers into potential capitalists and subvert the Marxian premise of class differentiation and conflict. This challenge, however, does not violate the principal notion of capital as an investment of resources in the production of surplus value. Rather, it incorporates skills and knowledge as resources, and thereby claims that skilled, knowledgeable laborers themselves hold such capital.

In summary, human capital theory deviates substantially from classical Marxian theory in several ways. First, while Marxian theory focuses on the production and exchange of commodities, human capital focuses on a process associated with the *laborer*. This change of focus is enormously significant. In the classic theory, value is assessed relative to labor costs rather than to the laborer, since laborers are considered interchangeable members in a large, available, competitive pool of workers who simply provide the socially necessary minimal and similarly skilled labor in production. Capital results from a successful calculus between the relative costs of production and prices in the exchange of commodities. In human capital theory, however, it is the laborers themselves, rather than the labor they perform, who figure centrally in the calculus of capital. In this view, capital is seen and calculated as the added value to the laborer, not to labor or the commodity. In other words, the major theoretical orientation has been changed. Labor, rather than being treated as a contributing factor in the exploitive relationship between the capitalist and the laborer, is seen as generative of capital for the laborers themselves. The social relations between capitalists and laborers are modified. Laborers can no longer be treated as replaceable commodities; differential values and payments are due to different laborers, depending on the capital they bring to bear on production – the human capital. Where do laborers acquire human capital? By gaining education, on-the-job training, or work experiences; by remaining physically healthy and able; by migrating to places where demands are higher; and so forth. This stance completely subverts the core orientation of the classic theory, which ties capital to the control of production means resting solely in the hands of the capitalist.

Secondly, and related to the first point, the laborer can now be seen as the *investor*, or at least as a party in the investment scheme. In the original Marxian analysis, laborers offer their labor in exchange for a wage to sustain their subsistence needs. Human capital clearly assumes

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