2004

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Publication Details

Ville, S, Social Capital: An Insight Revealed or a Concept Too Many?, Working Paper 04-05, Department of Economics, University of Wollongong, 2004.

University of Wollongong
Economics Working Paper Series
2004

http://www.uow.edu.au/commerce/econ/wpapers.html

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WP 04-05

June 2004

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Abstract

An introduction to social capital and a 'state of the art' analysis is provided. Attention is drawn to disagreements in use of the term, particularly between its innate and planned, individual and collective natures. It is argued that no inconsistency exists, rather it is a multifaceted concept. Alternative measurement techniques are discussed, along with pointers from historical research, and the principal economic effects of social capital. We conclude with recommendations for future research directions.

Introduction

The social capital concept rose to prominence during the 1990s. It has generated a broad range of reactions amongst economists from those who have heralded it as the discovery of a vital missing piece in the jigsaw of modern economic analysis to those who conclude that it is too amorphous and imprecise for economic reasoning and risks deflecting mainstream analysis down false pathways. This paper analyses the current state of research into social capital and, while recognising its current limitations, suggests new research agendas motivated by the concept. We begin by looking at the origins and definitions of the term, assess its claim to be a form of capital, and explain divergent interpretations of its key properties. The principal influences on the level of social capital are analysed and the various techniques used to measure it are investigated. We then overview historical trends in social capital and the economic outcomes it provides before concluding with pointers for new research agendas.

Origins and definition of social capital

Social capital, as we understand it today, came into common parlance in the 1990s although the ideas it conveys have been around much longer and the term social capital itself was used previously in different contexts.[2] Hanifan (1920) and Jacobs (1961) were among the pioneers in the use of the term. More recently, Loury (1977), Bourdieu (1986), Coleman (1988), Burt, (1992), and Portes (1995) placed social capital at the centre stage of their research and set the foundations for our modern understanding of the term. Putnam's bestselling book, *Bowling Alone* (1995), brought social capital to the attention of a much wider audience.

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1 I gratefully acknowledge the comments on this paper by Frank Neri

2 Some of the other terms associated with social capital include intangible assets, social energy, social capability, sociability, moral resources, ties/networks, social infrastructure, and social fabric. Woolcock, 'Social capital and economic development', p. 153, Maskell, 'Social capital, innovation and competitveness', p. 121. Negative social capital is sometimes referred to as social liability. Gabbay & Leenders, 'Social capital of organizations', p. 6.

At the heart of social capital is, 'an attribute of an individual in a social context'.[3] Specifically, it is the idea of shared trust-based norms that foster cooperative behaviour, particularly in the form of goodwill and reciprocity. These shared norms vary from simple friendship to a complex set of values and doctrines.[4] They may be shared through a bilateral relationship but are more commonly associated with a group or network of individuals. Networks may be informal in nature, for example based upon kinship, neighbourhood, or co-working, or they may be more formalized such as a community organization. Organizations can include, for example, religious denominations, fraternal societies, trade unions, political parties, professional societies, sporting clubs, and environmental groups. Membership of such an organization is not social capital itself but an indication of its manifestation, which is why a number of writers including Putnam have used changes in the extent and membership of organizations as a measure of social capital. It is assumed that community organisations tend to draw together individuals that are likely to be cooperative and that they are environments that will foster increased trust in the future. Vertical or hierarchical organizations such as companies are also viewed by some writers, particularly Coleman, as receptacles of social capital although sceptics point out that hierarchies can impede tendencies to cooperation and trust.[5] A more encompassing view again includes the development of formal institutions, such as the rule of law, civil liberties, and good government, as the product of high levels of social capital. Indeed, participation in broad community-wide organizations, such as government, is viewed as a manifestation of social capital through the desire for civic engagement.

Is it a form of capital?

Social capital is an asset derived from being part of a group with beneficial shared norms. It may be regarded as a form of capital since it helps to sustain income streams over time although in a much more dissipated manner than more conventional forms of capital that are tied to specific outputs. However, Arrow (1999) has questioned whether social capital should be regarded as a true form of capital. He argues that forms of capital share three common features: use over time, sacrifice, and alienability. In his view social capital only fills the first of these conditions, use over time. Others disagree: investment in social capital requires time and cost sacrifices associated with relationship building and establishing one's credentials within a group.[6] Alienability is more problematic particularly where social capital is closely allied with individual reputations. However, under particular conditions social capital can be bought and sold, for example the sale of the goodwill in a business derived from building good customer and community relations.

Social capital shares a number of similarities with human capital. Both are intangible forms of asset.[7] They share technology features insofar as their existence affects the productivity of other forms of capital including each other and physical capital. Thus, a social capital rich environment encourages the sharing of expertise,

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3 Bourdieu quoted in Sobel, 'Can we trust social capital', p. 139.

4 Grootaert, 'Social capital: the missing link?'; Fukuyama, 'Social capital and civil society'.

5 For example the Catholic church in southern Italy. Putnam, *Making democracy work*.

6 For example, see Sobel, 'Can we trust social capital?', pp. 144-5; Bourdieu, 'The forms of capital', pp. 248-9.

7 A growing group of intangible capitals also includes cultural and environmental capital.

while the existence of high levels of human capital will increase the returns to trust based behaviour.[8] Both are therefore complements rather than competitors to other forms of capital. Social and human capital are simultaneously investment and consumption goods, that is, both an input and output in the production process. This derives from the fact that they are preference as well as incentive based, pleasure being derived from their consumption, whether it be a first year economics lecture or a social drink at the club! Both can additionally be viewed as a mix of innate long term capital stocks and shorter term investment decisions. Stocks of human capital increase rather than decrease with use, as the brain is stimulated in the process of providing outcomes. The matter is more complex for social capital. Some writers such as Ostrom believe social capital also increases with use since successful exchanges reaffirm trust and cooperation. On the other hand, the cashing in of one's reciprocity credits to complete a transaction may necessitate new investments in the relationship. These shared properties suggest a bifurcation of capital between the intangible social and human, on the one hand, and the tangible, physical capital on the other hand. In order to address the nature of social capital more closely we need to analyse its key properties.

Key properties of social capital

One view of social capital holds that it is predetermined by long term historical forces and institutions such as location, tradition, and ethnicity.[9] Such social capital is endemic, innate,and intrinsic to a society and thus path dependent, being subject only to change in the long run.[10] It is a by-product or externality of larger social forces. An alternative view is that it is strategic, planned, and decision-based, and thus subject to change in the short run through the will of key actors.[11] These alternative visions of social capital call forth different types of economic analysis. Endemic social capital can be incorporated as a given within short run analysis and requires only an understanding of the forces shaping its level. Planned social capital, on the other hand, plays a more active and complex role: assumptions need to be made about the circumstances under which actors, including individuals, firms, and governments, will seek to increase (or decrease) the level of social capital and how changes in its stock will impact upon other variables.

While history and setting certainly matter in determining the overall stock of social capital, it is equally clear that individuals, companies and even governments have the ability to initiate short term changes in levels and patterns of social capital. Therefore, the total stock of social capital is composed of two elements, an underlying long term amount, probably representing the majority, and a smaller amount on the margin that can be actively manipulated in the short term. We look at the influences on these two forms of social capital in the next section. This disaggregation of social capital helps resolve disagreements about its capital-like properties that were

8 Woolcock, 'Social capital and economic development' p. 154 has noted that the latest technology and brightest mind is limited in what it can achieve without 'access to others to inform, correct, assist with, and disseminate their work'.

9 Although some writers have referred to this as cultural capital. Borjas, 'Ethnic capital'.

10 Maskell, 'Social capital, innovation and competitveness'; Coleman, 'Social capital in the creation of human capital'; Putnam, *Making democracy work*.

11 Glaeser, Laibson, & Sacerdote, 'An economic approach to social capital'; Bourdieu, 'The forms of capital'; Sobel, 'Can we trust social capital?'; Wallis & Dollery, 'Social capital and local government capacity'.

discussed in the previous section. While endemic social capital is not likely to require sacrifices or be alienable, its planned form is. Moreover, the two types of social capital appear to be mutually reinforcing, that is conducive conditions are likely to encourage social capital investments – individuals are attracted to high trust communities because of the low cost high payoff from their decision.

A second divergence in the literature concerns the location of social capital with the individual or the community. While on the face of it the two approaches may be intertwined by dint of our earlier definition, there are different implications in terms of the nature and consequences of social capital.[12] Individual social capital traits include social skills and charisma while community traits are more concerned with the nature and performance of groups and institutions. The benefits of social capital accruing to individuals include better employment prospects, for communities it includes reduced crime. There are social as well as private benefits and costs of an individual social capital decision: joining an organisation impacts on other existing members as well as the joining individual. In many respects, these differences mirror the distinction between innate and planned social capital. Innate social capital rests in communities over the long term, planned social capital is the action of individuals seeking to improve their own position, not necessarily the community and possibly at the expense of other community members. However, whole communities including their governments can take planned social capital decisions.

There are additionally differences of opinion as to whether social capital can be considered a public good or at least possess strong elements of it. A number of writers, starting with Coleman, argue that the advantages of being part of a trust group are non-rivalrous and non-excludable; one person's benefits do not affect another's and no member can be denied those benefits. Fukuyama, on the other hand, argues that social capital is a private good since cooperation with others is vital to most individuals to fulfill their needs. Again we can usefully distinguish between the collective social capital as a public good and the individual social capital as a private good. Like most public goods, social capital in its collective form creates externalities, both positive and negative, that contribute to its under- or over-production. Third parties benefit from knowing that they can trust members of a cooperative network. On the other hand, being external to such a network excludes third parties from the competitive benefits of operating within the network. Underproduction can be mitigated where a leader emerges within the network or some other party, such as government or business, recognises the value of enhancing social capital.

Social capital's value is enhanced by its being transportable, adaptable, and convertible, that is, it can be moved between different locations and used in different contexts while not being entirely fungible. British migrants are believed to have transported their social capital tradition with them to the United States and other settlers nations including Australia, and thus into very different environments.[13] Within Australia, migrants from rural communities, heavily imbued with notions of trust and community, have carried these values with them to urban areas, one writer noting, 'you can take the person out of the bush but you can't take the bush out of the person'.[14]

Set against these positive features of social capital, however, is a negative one: it can be destroyed much more easily and rapidly than it can be created. One serious

12 Portes, 'The two meanings of social capital'.
13 Greene, 'Social and cultural capital'.
14 Evans, 'Participation in voluntary organisations', p. 31.

misjudgement can undermine long periods of trust-building, destroying an individual or even a community's reputation.[15]

Influences on the level of social capital

Empirical and conceptual work has helped to identify some of the key influences on the magnitude of social capital. Endemic social capital, while fixed in the short run, is dependent upon a wide range of longer term and overlapping historical, institutional, and locational factors. Cohesiveness fosters trust and cooperation. Thus, small communities characterized by ethnic or religious homogeneity and with high and relatively equal levels of income and education tend to manifest greater amounts of social capital, as do those with a strong sense of internal identity and geographic boundary.[16] Mobility, by increasing the movement into and out of the group, is likely to diminish social capital.[17] Thus, location-specific investments such as home ownership, long term employment, and kinship constrain mobility and enhance social capital. Labour mobility, though, has long been viewed by economists as efficiency enhancing by mitigating frictional unemployment. The net effect of mobility on efficiency is therefore made ambiguous by integrating social capital into our analysis.

Influences on planned social capital must be viewed within the context of optimal investment decisions. Becker, for example, has viewed it in terms of rational choice utility maximisation – people chose those networks that will maximize their personal utility.[18] Glaeser et al present a model of individual investment in social capital very similar to standard ones for physical and human capital.[19] The principal influences are presented as: age (inverted U-shape profile); mobility (reduced social connectedness); an occupation where social skills are important; home ownership (reduces mobility); physical distance and high travel costs (reduces connections); and the individual patience to build relationships. However, the timing and nature of utility are broadly interpreted. A form of delayed reciprocity drives investment behaviour, short term altruism but long term self-interest. In other words, individuals expect their favour to be repaid in the future if needed. They seek a mix of market returns, such as better employment and higher wages, and non-market returns, which often include improvements in relationships, health, and happiness.

Measurement

Measuring social capital presents significant problems particularly in light of the disagreements over its definition and key properties. Comparisons of social capital between time and place can be drawn through percentages or ratios, for example the degree of trust shown by individuals or the number of organizations or memberships per capita in a community. However, it is difficult to derive a common unit of measurement for absolute levels for the purpose of drawing broader comparisons with, for example, other forms of capital, or with a nation's GDP. Writers have varied

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15 Woolcock, 'Social capital and economic development', p. 191.
16 Coleman, 'Social capital in the creation of human capital'.
17 Glaeser et al, 'An economic approach to social capital' p. 450.
18 See Becker, *Accounting for Tastes*, pp. 4-6.
19 Glaeser et al, 'An economic approach to social capital', p. 439.

in their faith in current measurement techniques. Solow, a sceptic on the question of social capital, remarked in 1995 that if the concept is to be taken seriously its stock, 'should somehow be measurable, even inexactly…measurement seems very far away'.[20] Measurement techniques have advanced in the decade since then. Let us look at the range of direct and indirect measurement methods that have been put forward.

Surveys

This common social science technique has been widely used in contemporary studies of social capital. Like all direct observation techniques it suffers from the impact of the survey itself on the participant, whether conducted face to face or anonymously. Ironically, the willingness of the participant to cooperate and answer honestly lies at the heart of the nature of social capital! This may polarize the results - cooperators are, perhaps, likely to exaggerate their cooperation, while non-cooperators may make an issue of the lack of prevailing trust. The most common question asked in major surveys like the World Values Survey[21] is that of general trust: 'Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people'. The question may appear to be a masterstroke of simplicity but it has its shortcomings. Most obviously, it does not define or delve more precisely into the nature of trust, nor is it clear who is meant by 'most people' and whether this concept would be interpreted with a bias towards regular contacts – friends and family – by some respondents but not others.[22] A second social capital indicator used by the World Values Survey is civic cooperation. In this case, five contextualised questions are asked each with ten possible response categories from which an index for each participant can be constructed. However, these questions, which deal with such matters as cheating on taxes, benefits, and transport fares, reveal more about individual views of how others ought to behave than it does about their own actions.[23]

Experiments

Experimental methods, increasingly popular in economics, are viewed as a way of overcoming participant bias.[24] Rather than ask opinions, experimental methods seek to elicit a sincere response by working through a laboratory scenario that mimics a real world reaction by the participant. Social capital may well be suited to measurement through experimental economics. A number of experiments have taken place including the dropping of wallets to see how many are returned to their apparent owners. This survey, by the *Readers Digest*, produced results similar to that of the World Values Survey, suggesting perhaps that these different measurement techniques can be used to verify each other's findings.

Counting organizations

For longitudinal and cross-sectional historical studies, surveys and experiments cannot be used, assuming that no participants are living. Alternative

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[20] Solow, 'But verify'p. 36.

[21] This major survey of thousands of respondents in nearly 80 societies variously covers 1980, 1990-1, 1995-7, 1999-2001. See: http://www.worldvaluessurvey.com/

[22] Knack and Keefer, 'Does social capital have an economic payoff?'.

[23] See Maskell, 'Social capital, innovation and competitiveness' for more discussion of the problems with survey techniques.

[24] For example, see Kagel and Roth, *Experimental Economics.*

approaches therefore are needed to enumerate social capital levels from the historical record. For example, trust, or lack of it, may be inferred from extant correspondence. In most cases, however, this would be a fortuitous by-product since correspondence would infrequently address the issue directly in the manner of surveys and experiments. Correspondence is unlikely to cover a sufficient cross-section of the population of a locality or nation, being heavily skewed towards the upper social echelons.[25] We saw at the beginning of the paper that membership of organizations is viewed as a manifestation of levels of social capital and, since the counting of these organizations is often possible, this has emerged as the major form of historical measurement of social capital. This was the basis of Putnam's famous study: the decline of social capital in twentieth century America was tracked through reduced participation in community groups.[26]

Again, there are major pitfalls in this form of measurement. Social capital manifests itself in many highly informal groups down to the level of friendship and extended kinship, none of which could be measured accurately in the historical record. If we focus, however, solely on measuring that component of social capital manifested through formal organizations, we face substantial definitional problems due to their heterogeneous nature. How do we account for the greater importance of some organisations than others? Measuring their size through membership is one approach and additionally gives an indication of how encompassing they are in their coverage. Their asset size, on the other hand, tells us something of their likely influence on a society and its value system. We also need to assess how engaged with each other are its members: are they geographically concentrated and meet and interact regularly, or rely upon remote communication through technology. Alternatively, members of a large national organization may rarely interact with one another. Further, the ethos of particular organizations may be conducive to civic engagement and cooperation; welfare, community action, and environment groups may fit this picture better than political groups or professional associations.[27] These measurement problems present difficulties but, where suitable historical evidence is extant, estimates are still possible bolstered by a contextual discussion. Putnam (1995) recognizes some of these problems and constructs a composite index of social capital from 14 indicators based on these organisations.

Fukuyama's equation

Fukuyama[28] has derived a mathematical equation to express social capital:

$$SC = [(1/r_n) r_p c n]_{1..t}$$

n = size of membership for t organizations
c = internal cohesion of an organization
r_p = radius of trust
r_n = radius of distrust

[25] On the other hand, there is no participant involvement and often by-product comments are the most accurate and revealing.
[26] Putnam, *Bowling alone*.
[27] Knack and Keefer, 'Does social capital have an economic payoff?' pp. 9-10 distinguish 10 different types of formal association.
[28] Fukuyama, 'Social capital and civil society'.

His equation is a refinement of the counting organizations approach of Putnam and others. n is the size of membership summed for t organizations. As we saw earlier, organizations are an heterogeneous unit of analysis. Some are more cohesive and capable of collective action than others, which c, a coefficient of cohesion, seeks to capture. Organisations are also characterized by varying levels of internal and external trust. Regular interaction and a community-minded philosophy will extend the radius of trust, r_p, to more members and perhaps beyond the group as a result of reputational effects, in which case the coefficient will be greater than 1. A society may be characterized by large numbers of cohesive organizations with high degrees of trust (that is large c and $r_{p)}$) but this may not make for a large stock of social capital if these groups typically look like the Mafia or the Klu Klux Klan. Thus, the relationship of organizations with the rest of society is important. Group affiliation therefore can generate negative externalities with the rest of society, which Fukuyama represents as the radius of distrust (r_n). As an expression of social capital, therefore, the reciprocal $1/ r_n$ is used.

There are some shortcomings with this approach. It effectively counts organizational membership, though in a refined manner, rather than actual social capital in the form of shared norms. The variables are not entirely independent of one another, for example c and r_n, that is internal cohesion often creates external distance. The equation relies upon a series of coefficients to capture largely qualitative functions so it will give us an approximate and impressionistic result rather than a quantitatively precise one, although this is not necessarily a disadvantage particularly in the type of comparative analysis that may be suitable for social capital. Obtaining even approximate data to operationalise the model for large numbers of groups, however, is problematic. One possible solution is to characterise all organizations by type. Knack and Keefer, for example, distinguished 10 activity types in their empirical work. Each type could be assessed for their cohesiveness and trust according to factors such as their extent of member interaction and their philosophy. Thus, one might expect that social welfare and environment groups would do well on trust, sporting and labour organizations on cohesion.

Proxy indicators

In the last few years a broader and more closely specified range of social capital components have been developed and integrated into a single analysis. Black and Hughes developed a series of components grouped under three headings. ‘Patterns of processes’ deals particularly with evidence of social and civic participation; ‘qualities of processes’ relates to feelings such as social trust, altruism, reciprocity, and a sense of community; ‘structures that enhance social processes’ specifically relates to conflict resolution mechanisms. Breaking social capital down into more discrete components may help measurement. However, there remains the problem of inaccurate counting of ‘patterns’ and the lack of secondary evidence of ‘qualities’ where surveys are not possible. MacGregor and Cary have developed a series of proxy indicators to supplement the primary and secondary data. These relate to expected social capital outcomes. They take two forms: proximal indicators are the outcomes of specific social capital components; thus low crime rates might be an outcome of a high trust environment. Distal indicators are outcomes associated generally with social capital rather than a specific component. These distal indicators include labour force participation rates, youth unemployment, and family income levels. They are mostly premised on the association of a poor economic performance in social capital deprived communities. However, the nature and direction of causality between social capital and economic wellbeing is not clearly understood in the existing state of the literature.

Intangible assets

So far our measurement techniques have largely focused upon innate social capital. We turn now to measure planned investments. In addition, we offer measurement in a financial unit allowing a broad range of comparisons to be drawn. Firms frequently invest in social capital, either internally to strengthen cooperation amongst employees, or externally to build trusting relationships with customers, suppliers, or other firms in the same industry. The goodwill generated by these investments is in effect embodied in the firm's net value as an intangible asset. Identifying this goodwill investment and separating it from other assets, however, is difficult. Firms frequently record 'goodwill' on their balance sheet to reflect the premium paid to acquire another company above the market value of the latter's net tangible assets.[29] However, such a premium also incorporates the acquirer's perception of the value that it can add after takeover through the strategic capabilities of its management team. It is difficult to disentangle these two explanations of the acquirer's premium. Moreover, one might expect the intangible as well as the tangible assets of the firm to be factored into the share price to some degree since investors would be aware, for example, of branding and goodwill strategies. The timing of the goodwill valuations is critical since normal accounting practices lead firms gradually to run down the value of their goodwill, using accumulated reserves, until it shows a zero balance.

A more accurate measurement of goodwill can be obtained from primary evidence of the value attached to it by an acquiring firm. Naturally, this information is closely guarded so as not to weaken the bidding firm's bargaining hand. Any evidence is therefore likely to be found within the archives of major firms. Such an exercise has been undertaken for the Australian stock and station agent industry.[30] Agents worked closely with farmer clients in wide-ranging relationships covering financial, marketing, and technical services. They saw substantial benefits from building up social capital, particularly the reduction of the transaction costs of doing business with farmers and the opportunity to build up additional clientele. In the course of the twentieth century a group of agents gradually controlled the industry through the acquisition of most small firms. Since many of the acquired agents were private firms, it behoved the bidding company to undertake a careful due diligence of the business including detailed valuations of all constituent parts, particularly intangible assets. The evidence we have from such takeovers reveals goodwill's share as mostly between two-fifths and two-thirds of the purchase price. In one case the acquired firm had no tangible assets, with the bidder paying solely for the goodwill. This is broadly consistent with balance sheet evidence showing that the social to physical capital ratio could be more than one in some cases.

Historical trends

How does history help us understand the nature and significance of social capital? Currently, historical studies are relatively limited and, like contemporary and

[29] Fukuyama, 'Social capital and civil society'.

[30] Ville, 'Social capital formation'.

conceptual work, provide a bifurcated perspective. The initial thrust of historical research on social capital pointed to its decline over time. Most famously, this is associated with Putnam's story of the decline of civic engagement in the USA from about the 1960s as the consequence of the rise of the 'anti-social' television.[31] Other studies have delved much further back in time to find an historical tradition of social capital. Medieval European economies have been strongly associated with notions of gift-giving, laden with values of obligation, delayed reciprocity, and the coalescence of social relationships with economic transactions. The subsequent development of markets, based upon closely specified arms-length transactions, is viewed as a shift away from social capital.

Medieval British villages and European guilds and communes have been proffered as hotbeds of social capital. Close village communities fostered cooperation and shared norms, expressed both informally through neighbourliness and by way of local institutions such as the parish church, secular courts, and charity groups.[32] The accumulation of large stocks of social capital in Britain by the eighteenth century has been viewed by Szereter as an important prerequisite for subsequent rapid economic growth.[33] Similarly, European merchant guilds have been portrayed as beneficial social networks, while in Italy, public arenas, such as piazzas and promenades, were viewed as facilitating civic engagement.[34]

The subsequent decline of social capital has been attributed to a variety of factors. The transition to industrial society replaced the village community with an alien urban environment and the benign neglect of *laissez-faire* government. In due course, informal social relationships, norms, and community support through voluntaryism were replaced by the more formal and remote institutions of the national state and legal systems. The expansion of government jurisdiction is thus perceived as reducing civic participation over time. Greater personal and informational mobility, through waves of transport and communications innovations, have apparently also contributed to the breakdown of self-contained communities and weakened the value of their information-spreading properties.

An alternative historiography, however, suggests a more complex picture where social capital, in somewhat different guises, remains as important as in the past. Fukuyama's 'end of history' thesis views the transition from a system of gift-giving to market economies as complete, and, when combined with the forces of globalisation, mean few future benefits will be derived from differences in location or technical change. Instead, he argues, future competitive advantages will be vested mostly in cultural differences particularly matters of trust and ethical behaviour.[35] This has motivated discussion and generalizations about relative trust levels in different economies.[36] Moreover, levels of social capital in the distant past are now seen as less impressive. Medieval guilds are revealed as suffering from internal divisions and disagreements,[37] while Ogilvie's 'bitter living' thesis identifies the many outsiders, particularly women, who suffered at the hands of exclusive merchant networks.[38]

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31 Putnam, *Bowling alone.*

32 McIntosh, 'The diversity of social capital'.

33 Szereter, 'Social capital, the economy and education'.

34 Muir, 'Sources of civil society'.

35 Fukuyama, *Trust.*

36 For example high trust (Japan, Germany, United States) and low trust (China, Italy, France) nations.

37 Rosenband, 'Social capital in the early industrial revolution'.

38 Ogilvie, *Bitter Living.*

The story of declining social capital in urban industrial towns is more complex. The vertical links between social groups in Medieval villages gave way to powerful horizontal ties within social groups, living contiguously in the cities, a relationship sometimes referred to as class consciousness. This, in turn, engendered a more paternalistic environment as city elders introduced a widening array of social services from the mid nineteenth century designed to mitigate the risk of social disruption. The extension of the franchise to the urban working class in Britain from 1867 was driven by similar efforts to restore levels of social capital. The success of 'soft loan' societies among the working class Jewish communities in New York and London at the end of the nineteenth century testifies to the continued strength of social capital in urban environments.[39] Paterson's study of the shift of the monarchy (1603) and most central government institutions (1707) to London reveals little impact on the Scottish community from enlarged jurisdiction. Social capital, he argues, continued to work mostly through local schools, churches, and hospitals.[40] As we saw earlier, the broad definition of social capital includes a role for modern formal national institutions. Wallis and Dollery have drawn attention to the way that governments in the 1990s have become increasingly aware of the need to engage with local communities by opening up their 'political opportunity structure', that is, the access to political authority. Governments can exert a major influence upon the level and distribution of social capital through their educational and social policies.[41]

While improvements in transport and communications over the last two centuries have certainly led to a breakdown of the self-contained local community, this has changed the nature of social capital rather than led to its demise. Bridging social capital has increasingly replaced bonded as links and associations extend between communities, and networks begin to overlap with each other. This increases the range and amount of connections with positive implications for the scale of business and other forms of economic activity. It is particularly important, therefore, in removing the growth restraints for ethnic entrepreneurs. Greif's excellent study of the Maghribi traders' coalition shows how these Medieval merchants hired only an agreed list of Maghribis as their overseas agents in order to mitigate agency costs. By not trading with non-Maghribis, these merchants limited the scale and efficiency of their trading enterprises.[42] By contrast, Ueda has shown how second generation American immigrants in the early twentieth century were often bridge builders from their ethnic to the broader community.[43] On a broader geographical basis again, trust can now be built over very long distances and on a more impersonal basis; for example our willingness to trust our credit card details to an unknown employee of an overseas supplier of goods or services.

Inspite of the increasing volume of public information available in our modern society, access to rich and privileged sources of private information as a basis for strategic decision-making remains a potent force for building social networks. This is reflected, for example, in the enduring popularity of interfirm agreements to garner knowledge and the use of advisory sharebrokers inspite of the vast amount of public

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39 Godley, 'Jewish soft-loan societies'.

40 Paterson, 'Civil society and democratic renewal'.

41 Wallis and Dollery, 'Social capital and local government capacity'; Hall, 'Social capital in Britain'.

42 Greif, 'Institutions and international trade', pp. 130-1. Other early trading networks are discussed. For more detail on the Maghribis see Greif, 'Contract enforceability and economic institutions'.

43 Ueda, 'Second-generation civic America'; also see Granovetter's idea of coupling and decoupling, 'Economic sociology of firms'.

information available on technical change and the performance of listed companies. Bowles and Gintis have taken the question of information and social capital a step further. They argue that in the early industrial age, the simple and quantitative nature of manufacturing production inputs and outputs (for example coal, cotton, steel) made for relatively standard contracts that were easily monitored and enforced. Our modern business structure, with many information intensive industries, deals more in heterogeneous qualities than homogeneous quantities, which makes for highly complex transactions and a growing problem of contractual incompleteness. In these circumstances, relational contracts, drawing upon social capital features such as shared norms and reciprocity, can provide a more efficient transacting environment.[44] Overall, then, social capital, far from being superseded by the marketplace, has survived because of its ability to enhance market exchange; in Fukuyama's words, it is the glue that holds together the centrifugal forces of the market.[45]

Economic outcomes

An environment of enhanced trust, cooperation, and information flows due to high stocks of social capital provides major benefits in terms of market efficiency at the microeconomic level and of economic development at the macroeconomic level. Most obviously, opportunism is mitigated, thereby reducing the transactions costs of highly specified contracts and close monitoring. The need for contract enforcement institutions such as legislation and the courts is minimized in circumstances where this is helpful such as in small or local communities, or in developing nations. As a result, the volume of market exchanges is increased due to the falling incidence of market failure from high costs. Innovation is similarly encouraged by the reduced risk of infringement and the commitment of fewer resources in protecting the innovator. The enhanced sharing of information is also a driver of higher rates of technical change. The willingness to reciprocate knowledge helps resolve the paradox of information – an inability to know its value before it is purchased prevents many valuable transfers of knowledge.[46] An enhanced information environment improves decision-making, especially through reference to the private and privileged information that characterized these network relationships.

As we saw earlier, social capital has been viewed as either a collective or an individual trait. It can help to solve collective decision problems such as the underconsumption of public goods or the actions of free-riders. For the individual, social capital traits can improve employment prospects and income levels. The delayed reciprocity of social capital investment has also been used as a form of insurance, by the poor in Medieval Europe and in developing nations today, where much of the population barely subsists. The agrarian basis of most of these economies creates additional uncertainty through severe annual fluctuations in output. Mitigating these uncertainties and building a conducive local environment for exchange, investment, and innovation is viewed as a viable 'bottom-up' means of economic development. Exploiting the growth potential of local embedded institutions, including kinship and neighbourhood, is increasingly viewed as a viable alternative where top down development does not work.[47] High levels of social

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[44] Bowles & Gintis, 'Scial capital and community governance', p. 433.

[45] Fukuyama, *Trust*.

[46] Arrow, *Essays in the Theory of Risk-Bearing*, p. 152.

[47] Maskell, 'Social capital, innovation and competitiveness', pp. 119-20.

capital enable communities to work with more formal institutions, such as banks, to achieve traditional-sector-enrichment growth policies.[48] As the bonded social capital of individual communities is gradually superseded by bridging investments, so the bottom-up initiative broadens into a national pattern of development.[49]

Not all economic outcomes are positive. Economic decisions based upon norms of trust, obligation and reciprocity may put a lower order of importance upon arms-length imperatives: outcomes may be based upon maintaining good social relations within the group when in fact the optimal economic decision would have been one that leads to division and disruption, perhaps 'creative destruction'. Organisations create barriers with the outside world, the so-called radius of distrust. Indeed, there may be a positive correlation between their internal cohesion and their negative externalities, which mitigates their economic benefits. Access to privileged information within the network provides members with a comparative advantage but also creates a comparative disadvantage for non-members. Mancur Olson's institutional sclerosis hypothesis argues that small well-organised groups are effective rent-seekers that can divert governments from pareto-efficient policies.[50] On the other hand, the enhanced civic engagement and participation that is frequently associated with social capital strengthens democratic institutions and the probability that decision-making will be pareto-optimal. An additional risk is that of a maverick entering the social network who is able to exploit the trusting environment for personal gain; the notion of affinity fraud has recently been highlighted by the Australian Securities and Investments Commission.[51] However, in most cases trust-based groups will find ways to vet and monitor new entrants and, if that fails, will eject the maverick in due course.

There is limited empirical analysis of the relationship between social capital and economic outcomes. Knack and Keefer have sought to measure trust and civic cooperation using the World Values Survey for 29 market economies in 1980 and 1990-1. Their results show a strong and significant positive relationship to economic growth. Trust and civic norms were found to be greatest in nations with higher and more equal incomes, with well-educated and ethnically homogenous populations. The positive relationship between growth and social capital, however, was strongest in poor countries, confirming the intuition that informal institutions are an important substitute where financial markets are immature, property rights weak, and contract enforcement ineffective. This provides an alternative approach to the traditional literature that the State should provide an institutional substitute for late developers lacking these necessary prerequisites for modern economic growth.[52]

Conclusion: a new research agenda

Social capital is a valid and useful term to add to the lexicon of economics. In particular, it distinguishes and explains the non-standard relationship between

48 The Grameen Bank in Bangladesh is often cited as an example of this, group cooperation ensuring very low default rates and the provision of loans to very poor Bangladeshis.

49 Woolcock, 'Social capital and economic development', p. 171.

50 Olson, *logic of Collective Action; Rise and Decline of Nations*.

51 http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/affinity+fraud+can+it+happen+to+you?opendocument

52 An idea especially associated with Gerschenkron, *Economic Backwardness in Historical Perspective*.

economic actors. Relationships are values-based, the nature of which can have important economic consequences. Shared cooperative relations, in particular, facilitate market exchange, poor, or toxic, relations conversely impede economic transactions. Trust, or its absence, is the key difference. Social capital provides a much needed holistic approach to economics, linking macroeconomic and microeconomic frameworks of analysis as a unifying concept. As well as its internal 'bonding' mechanism, like the concept itself, it creates much-needed 'bridges' to other social science disciplines particularly sociology and political science.

The challenge for economists is to incorporate this helpful insight into the framework of their analysis. Immature as the concept is, there are disagreements regarding its key properties and problems in its accurate measurement. These bifurcated views may well be resolved into a conventional wisdom as conceptual discussion advances in the coming years. This paper has indicated that in a number of cases divisions of opinion simply reflect different elements of social capital; for example it can be both innate and planned, an individual and a collective trait. Similarly, with measurement, there is no universally accepted practice, but we do have different methodologies to fit alternative types of study – contemporary or historical, directly observed or received. In addition, in some cases, alternative approaches to measurement can be used for verification purposes.

Social capital will annoy some economists who will find it difficult to model or fit into a neoclassical orthodoxy. For others, these 'annoying' inherent properties will be part of its appeal, a healthy challenge, and an opportunity to break away from some of the constraints on behavioural analysis that have set economics adrift from its position at the centre of the social sciences.

New growth theory, probably the greatest challenge in recent years to neoclassical orthodoxy, inheres to a similar deceptiveness. Indeed, future conceptual research might investigate more closely the relationship between endogenous growth and social capital, in light of the ability of social capital to generate the type of informational externalities on which new growth theory draws. The interaction of human and social capital is also a prime topic for closer analysis, the synergies between the two noted earlier, suggest the possibility of a virtuous circle relationship.[53]

However, it is perhaps the empirical literature that requires most attention at this stage. Historical treatments are relatively few and have tended to focus upon individual contexts rather than draw bilateral or multilateral comparisons. Szereter has suggested that social capital was a prerequisite to the industrial revolution in Britain but we have no convincing comparative analysis similar to Sandberg's 'impoverished sophisticate' thesis of human capital in Scandinavia.[54] Comparative contemporary studies could make more use of experimental methodologies given the innate behaviourialism of social capital. Since governments can influence the level of social capital then such studies have policy implications. Putnam concluded that the rise of the television was largely responsible for the decline of club membership in the United States. Given the subsequent emergence of a more advanced and perhaps more anti-social technology in the computer, studies of its impact on social capital would be valuable.

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[53] Glaeser et al, 'An economic approach to social capital', p. 455 conclude, 'Better understanding this connection [between human and social capital] should be a key goal for future research'.

[54] Sandberg, 'Impoverished sophisticate'.

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3rd draft 15.06.04