Economist.com OPINION

Economics focus

A question of trust

Feb 20th 2003
From The Economist print edition

Economists are arguing about "social capital"—starting with what it means

WHAT gives rise to the wealth of nations? Some see the source in rich seams of mineral resources such as oil or coal. Geography matters too: countries in temperate climes tend to be richer, other things being equal, than those closer to the equator. Then there are institutions: the rule of law and (perhaps) democracy. Above these, most economists since Adam Smith have believed, stands the invisible hand of the market, guiding selfish human actions to serve the common good.

Is there something missing from the list? For the past decade or so, sociologists have been pushing one more concept, "social capital"—trust or community, in one of its guises—that is now also being taken up by economists. Crudely speaking, the more people trust each other, the better off their society. They might work more efficiently together, for example. In business, trust might obviate the need for complicated contracts, and thus save on lawyers' fees. You might expect that America, which has such a successful economy, had social capital in shedloads. Maybe, and maybe not: one of the most influential essays in the field, "Bowling Alone", by Robert Putnam of Harvard University, pointed out that Americans were far less likely to be members of community organisations, clubs or associations in the 1990s than they were in the 1950s. He illustrated his thesis by charting the decline of bowling leagues.

A recent set of articles in the *Economic Journal** shows how economists are grappling to analyse social capital. On the face of it, the idea that trust or community can make a difference between wealth and poverty does not fit easily with the basic assumption of orthodox economic theory: that humans are essentially self-interested animals. That is why it has an instinctive appeal to "behavioural" economists, who think that this assumption has been accepted too uncritically.

In one paper, Samuel Bowles and Herbert Gintis, of the University of Massachusetts, advance just such a view. They argue that, if social capital is taken into account, economists have to put aside the idea that people are simple, self-interested economic machines. People donate their time to all sorts of things, from voting to teaching in Sunday school, whose costs outweigh the private benefits. Obviously, argue Mr Bowles and Mr Gintis, humans are social animals.

This could be explained away easily, though, by making the assumption that people derive utility from helping others at their own expense. But the authors think that something more sophisticated is required. They carried out experiments, using university students, to see how a group of people might encourage each other to act in the interests of the group as a whole. Many subjects, it seems, take pleasure in punishing free-riders. Many respond to the shame of being found out as shirkers, which encourages co-operation. The lesson is that notions of selfish, or indeed altruistic, preferences cannot explain the incentives of people in a village, school or parish. The authors conclude that such communities are the missing ingredient, alongside markets and the state, in understanding an economy.

No, it does not take a village

In another paper, Edward Glaeser and David Laibson of Harvard University and Bruce Sacerdote of Dartmouth College take individuals, not groups, as their starting point. They also use a more individualist definition of social capital: a person's social skills. This can mean a long list of contacts, a facility for dealing with others, or even just charisma. The authors include popularity in their definition, since it can be the result of investing in personal relationships. They measure people's stock of social capital by the number of organisations—clubs, charities, religious groups and so forth—to which they belong.

The authors see social capital as something that people can build for themselves, rather as they build financial wealth by saving or investing, or "human capital" by acquiring skills and education. A doctor, for example, might invest in more than just medical education: by joining a local club, she could get to know her patients better and perhaps increase her future income.

Messrs Glaeser, Laibson and Sacerdote find that investment in social capital, as they define it, has similar characteristics to investment in financial or human capital. People join professional societies, say, when they are young and reap the benefits when they are older, relying on business contacts made early on, just as they do with savings. People also invest more in social capital the more likely they are to remain living in the same place; the "bowling alone" phenomenon may be partly attributed to rising mobility. They also invest more in social capital the more they stand to gain from it. When there is nothing in it for them, they neglect their neighbours. *Homo economicus* lives.

By definition, however, decisions to invest in social capital affect not just the individuals making them but others too. It is tempting, if social capital is defined in terms of community or trust, to see such spillovers as always positive. But they may not be. For instance, if people act in the interests of a group to which they belong, others can be harmed: a professional association, for example, may keep fees and entry barriers high, or some groups may exclude outsiders altogether.

In the final paper in the series, Steven Durlauf of the University of Wisconsin says that research into social capital may have become a bit too other-worldly. Existing data, mostly taken from surveys, are not up to the task of specifying social capital precisely enough. Perhaps too much has been invested in the concept of social capital to help explain why nations become wealthy. As more economists pile into this fertile area, expect more deflation of the concept—and also more argument.

---

*Volume 112, Number 483, November 2002

Copyright © 2003 The Economist Newspaper and The Economist Group. All rights reserved.