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Past Discussions and Current Evidence On the Importance of Social Capital

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Abstract – This paper intends to provide a summary of the emergence of social capital concept in the historical context. A special emphasis is given to the political and economic importance of social capital since many thinkers in the past are known to have expressed their ideas about the possible positive spillovers from social harmony to economic growth and political stability. Using contemporary data, the paper therefore conducts a simple statistical analysis, too. The findings of our simple analysis find statistically significant and positive relationship between the social capital level and growth in many of the emerging economies in accordance with the usual historical intellectual acceptance. However, it is the social capital across all the constituents in a society that affects the economic performance positively but not the social capital that generally comes into being naturally within smaller groups.

Keywords – *social capital, bonding capital, linking capital, bridging capital, social fund*

I. Introduction

Social capital simply refers to the network of relations in a society. A society with high level of social capital would under normal circumstances facilitate the easy and seamless establishment of both the horizontal and vertical social relations. Openness of communication channels between different groups, perceptions such as trust and fairness, and values regarding secularity and emancipation are accepted as important determinants of the degree of social capital in a society, among other relevant factors.

Social capital concept gained popularity in economics literature during the 1990s thanks to the works of Robert Putnam, a Harvard professor of public policy, and the World Bank's particular interest in the subject. However, social capital concept has a much significant background. In the historical context, intellectuals such as Alexis de Tocqueville and James Madison discussed the concept as early as in the first half of the 19th century, although they never used the term explicitly. According to Alexis de Tocqueville, for instance, what lied behind the emergence of an effective democratic society in the USA was the American society's tradition for discussing all matters on a broad range of subjects from economics to politics collectively. As aforesaid, this capacity of social constituents to get together and discuss social matters with an aim for reaching a consensus was correctly observed by de Tocqueville as a manifestation of social capital, although – as I said - he never used this term. Nevertheless, it is obvious that he valued the connection between the people implicitly as some sort of a capital for building a democratic society.

In fact, during the whole 19th century, views from a social perspective on how the economic and political capacities of a society come into being could be found in the discussions of John Bates Clark, Edward Bellamy, Henry Sidgwick, and Karl Marx among numerous other 19th century writers. In his 1897 book named "Equality", Edward Bellamy proposed to call the difference between the total wealth created by entire laboring workers and the immediate consumption required by the society as the social fund. Social fund at the end of the 19th century according to Bellamy's own calculations were 200 times higher than the one that would be attained if every worker produced individually. Hence, according to Bellamy, social fund was nothing short of a social creation. He believed capitalist was looting the social capital and he discussed in a utopian setting that it would be possible to afford the healthcare, education, cultural etc. needs of everybody from the social fund should the private capitalism ended. As Farr (2014) wrote Bellamy further believed that "a socialized economy under egalitarian conditions seemed ideally designed to foster dense networks of associations in community, organized activities of cooperative work, and heightened social capacities like sympathy and solidarity." Hence, the egalitarian use of the social fund was the core of building social capital that would enhance economic production.

Edward Bellamy lived in the Gilded Age. In the history of the US, Gilded Age, the era that ran from 1870 to early 20th century, which is notoriously known for the rapid disruption in the income distribution. In the three decades from 1860 to 1890, the real wages increased substantially in the US due to rapid industrialization. As a result, millions of immigrants poured into the US, hoping to embark on a better life. While some of them succeeded, millions ended up in extreme poverty. It is clear that Edward Bellamy was touched by the social questions of Gilded Age.

Among the European thinkers, Karl Marx used the term social capital (i.e. gesellschaftliche kapital in German) as early as in 1867. In the English-speaking world, John Bates Clark was among the first writers to use the term social capital, almost two decades later than Marx, in 1885. Clark, attended schools in Switzerland and Germany between 1872 and 1875. When he came back to the US, he was under the intellectual influence of German socialists. Clark would gradually become an advocate of capitalism as years passed but in this earlier stage of his career, he was refusing the classical political economic view of the time. Along with Clark, both Marx and Sidgwick were also upset with the classical political economic view, according to which capitalists had the entrepreneurial prudence and abstinence from daily consumption and their prudence and abstinence were enabling their funds and power to initiate. Workers were the labor they hired with their own funds, which were resulting from the capitalists' prior abstinences. However, Sidgwick, Clark, and Marx refused this idea of payments made to labor from the capitalist's own funds. They believed production should not have been related with the retrospective endeavors of only the capitalist but it should have been a prospective result of all the society's funds. According to Sidgwick, for example, the total sum of tools, inventions, land improvements such as roads and bridges and even the immaterial elements such as the organization of the state and the goodwill were parts of a social capital. Sidgwick, Clark, Marx all believed a social capital, i.e. an aggregation of many things in the society, provided an expanding fund for further production. Thus, social capital was a productive aggregation and it was also prospective. In every product, social capital was embedded to some degree. An excellent and more detailed discussion about the early conceptualization of the social capital could be found in Farr (2014).

Clearly, these early discussions regarding a capital that was resulting from the interactions of the whole society were different from the concept Putnam made popular at the end of the 20th century. Still, all the social capital discussions have a common denominator. They all believe that the associations and networks in a society between the different parts of the society are important for the sake of a greater good at the aggregate level.

This study will next try to answer if there exists any correlation between social capital and economic growth. The second part of this study will summarize the growth and social capital relationship on a theoretical basis. The third part will empirically reveal the correlation between the social capital and economic growth using the data from the six newly industrialized countries. The fourth part will conclude.

II. Social Capital As A Growth Determinant

Classical economists emphasized the traditional factors of production as the determinants of long-run growth. These were the land, labor, physical capital, and entrepreneurs – the last one being added to this list decades later though. After the Second World War, initially the Post-Keynesian economists Harrod and Domar drew attention to the importance of productivity growth. Following them, the productivity concept became a crucial concept for economic growth in the neo-classical Solow-Swan growth model. According to the Solow-Swan model, one of the workhorse models in the growth literature, societies could make economic growth sustainable and improve their life standards continuously only if their productive capacity keeps growing. However, productivity growth is an exogenous term in the Solow-Swan analysis since the model does not speculate on how the productivity could be enhanced.

This was an insufficiency of the traditional neo-classical approach to growth modeling and it was addressed in the 1980s by a group of economist who are known today as the pioneers of the endogenous growth modeling approach. 'Endogenous' here was the productivity term. Thanks to the works of Paul Romer, Robert Lucas, Sergio Rebelo among others, variables such as human development level, innovative capacity, technology investments etc. are known today as the variables affecting the productivity growth.

Starting from mid-1990s onward, 'the organizational attributes of society' also became a focal point for growth after the works of Robert Putnam and the interests of the World Bank and the OECD in the subject. In some countries, human capital level is increasing at a faster pace, innovative capacity is built more seamlessly, technology investments are funded more easily although technology investments are large, uncertain and long-term investments most of the time. What is different in these countries that makes them better in boosting productivity through human capital, innovation, technology etc. while some other countries lag behind so badly? Social capital is probably the answer to such a question. Let us then have a look at the different types of social capital as defined in the current literature.

III. Types of Social Capital

It is possible to classify social capital in different ways. According to one popular classification in literature, social capital has three different forms. These are (i) bonding, (ii) bridging, and (iii) linking social capital. The social arrangements and associations between the similar units in the society make the bonding capital, while those between dissimilar units make the bridging capital.

Both bonding and bridging capital are horizontal. Linking capital, on the other hand, is vertical. It creates the relationships between the different layers of the society or sometimes it might mean the relationships between the constituents and the institutions. Let us explain these classes in more detail.

3.1. Bonding Social Capital

Bonding capital refers to all of the relationships established between the parts of the society that share a common identity. Putnam describes it as the form of social capital that happens between the friends, close relatives, etc. That is to say bonding capital is formed within homogenous groups of people. By integrating the group members, bonding form of social capital also facilitates collective action within the group.

Close horizontal ties generally reduce the costs of making business, increase the group productivity and improve coordination and cooperation. For example, in the US, 70% of the new positions are filled up so quickly based on personal recommendations that these positions are never posted. According to some sources, the number of unposted jobs could be as high as 80% of all the new jobs. That means, the flow of information in the labor market is seamless thanks to personal relations. Plus, a matching problem between the job-seekers and worker-seekers is mitigated. Last but not least, the potential labor force loss that would occur until the position is filled is minimized. Of course, we assumed that the position is filled with a person who is capable.

However, Portes and Landolt (2000) argue that bonding capital might easily produce social bad rather than social good. That happens when people show favor to others in their group even though the group members are the less capable choices. As they point out, whenever bonding social capital leads to nepotism or favoritism, economic losses are likely to result.

3.2. Bridging Social Capital

Bridging form of social capital refers to horizontal relations just as the bonding form. However, this time the relations are not established within a homogenous group but between different groups. Yet it is a horizontal form of relationship because the two members of the two distinct groups associating with each other are not superior to each other with regard to a hierarchical ranking.

In business life, network management is a way of building bridging social capital. According to Ford and McDowell (1999) business fairs, the platforms where sellers interact with potential buyers and company visits between sellers and buyers strengthens the existing business relationships and make them permanent. In business management literature, since mid-1990s, increasing number of studies reported the importance of human relationships in business life (see Kanter, 1994; Contractor and Lorange, 2002; Dyer and Singh, 1998; and Inkpen and Tsang, 2005 etc.).

3.3. Linking Social Capital

Linking form of social capital is vertical. It is established between the distant people or institutions in a hierarchial order. The World Bank uses the term “enabling social and political environment”, which is briefly telling the benefits from such vertical connections. In a narrower context, one could claim that the linking social capital refers to the relationships of the formal institutions that form the social norms and social structure with the rest of the society. The legal system, political regime etc. could all be considered as parts of linking social capital.

In his 1981 book, “Poverty and Famines: An Essay on Entitlement and Deprivation”, Nobel laureate economist Amartya Sen claims that large death tolls from famines are not seen under democratic regimes. In 1943, when India was under British rule, a serious famine in Bengal resulted in three million people losing their lives from starvation. Sen notes that the food production had not declined radically in 1943. However, the population growth in Bengal region was driving food prices up. In addition to that, the food purchases of the British Army also pushed prices up in 1943 and people died of hunger only because they could not afford to buy the food. Thus, although the tragedy is named a famine, there existed in fact no food deprivation.

Sen claims, under a democratic regime, because the officials would be held responsible, they would be more interested in providing food to the needy people. That is to say being accountable to the public could cause a dramatic difference in a life or death situation. Being accountable, responsible, and transparent are important qualities for the construction of linking social capital.

IV. Interpersonal Trust And Economic Growth of NICs

The discussion on social capital to this point should have made it clear that measuring social capital level is tricky. It has an elusive description. However, the level of interpersonal trust for strangers could serve as a proxy to some degree since social capital is related with social ties, associations and the very feature that makes social capital important is its capacity to create a conducive environment for the improving political and economic wellbeing. Without the basic feeling of trust for others, it would simply be impossible to build up the desired social ties and associations.

And without trust, political environment would hardly be suitable to create social cohesion and economic environment to create trade linkages. That is to say, without trust, politics and economics would fail to deliver the desired ends from them. In brief, maybe interpersonal trust does not cover the whole meanings of social capital but it certainly is a necessary part of any type of social capital. For that reason, interpersonal trust for strangers is chosen as a proxy for social capital level.

Trust is measured for a number of countries by the World Values Survey (WVS) network. As their name suggests, WVS network conducts survey studies in different countries. They conducted six such survey studies until now. Their surveys are important for they ask (in a nationally adjusted way) the attendants whether they trust strangers or not. The first WVS survey was completed in 1981-1984 period, while the last one in 2010-2014.

Six newly industrialized countries (NICs), which have taken at least half of the six surveys, are chosen from the WVS database. The following table indicates the percentage of the survey attendants who answered “most people can be trusted” to a question on interpersonal trust.

Table 1. People who think “most people can be trusted” (% of survey takers)

	Brazil	India	China	Mexico	South Africa	Turkey
1981-84	n.a.	n.a.	n.a.	17	26	n.a.
1989-93	7	34	59	30	27	10
1994-98	n.a.	33	50	29	18	6
1999-04	n.a.	39	52	21	12	16
2005-09	9	21	49	15	n.a.	9
2010-14	7	21	60	12	23	12

Source: World Values Survey database
No survey done between 1985-1988

The following table reports the average GDP growth rates during the same time periods for the same set of countries. The correlation between the data in table 1 and table 2 (when data are pooled) is 0.72.

Table 2. Average GDP growth rates in respective periods

	Brazil	India	China	Mexico	South Africa	Turkey
1981-84	-	-	-	1.89	2.06	-
1989-93	1.18	4.55	9.13	4.24	0.03	4.59
1994-98	-	6.40	10.22	3.30	2.74	4.10
1999-04	-	6.18	8.92	2.20	3.42	3.08
2005-09	3.64	7.91	11.42	1.58	-	3.16

2010-14	3.29	7.28	8.56	3.35	2.45	5.45

Source: World Bank database
Blank boxes correspond to the n.a. data points in Table 1

Tables 1 and 2 together indicate that it might be possible to say the higher growth rates in NICs generally match with higher levels of social capital (for which trust is used as a proxy).

The following figure (Fig.1.) plots the average growth rates and average trust level in NICs. For Brazil, Turkey, India and China, there seems to be a linear relationship between the growth and trust. For Mexico and S.Africa, it is hard to claim that such positive relationship exists.

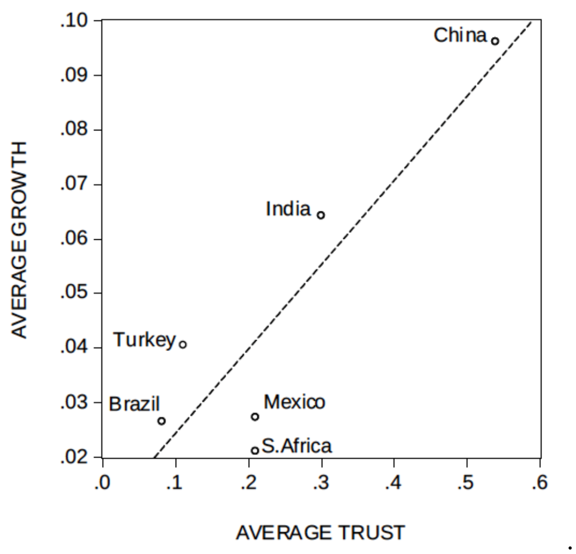

Fig. 1 Average Growth and Trust in NICs

The following table reports the heteroskedasticity and autocorrelation consistent OLS estimation results for the pooled data of the NICs. According to estimation results, trust is a significant variable for explaining growth rates in this dataset and the variations in this simple specification just with a constant term and trust are able to explain the 52% of the variations in growth rates in the NICs.

Table 3. OLS estimation results with pooled data

Dependent Variable: Growth				
	Estimate	**Std. Error**	**t-Stat.**	**P-value**
Constant	1.44	0.70	2.06	0.0495
Trust	13.06	2.15	6.08	0.0000
R-sq	0.52			

Heteroskedasticity and autocorrelation consistent (HAC) estimates reported

V. CONCLUSION

Social capital vaguely refers to the horizontal and vertical associations that build up the social cohesion. The discussions about the importance of social connections and ties for a better political and economic system are not new. In fact, during the 19th century, the importance of a social aggregate for the political and economic performance was thoroughly discussed by leading intellectuals such as Alexis de Tocqueville, James Madison, Edward Bellamy, Henry Sidgwick, John Bates Clark, and Karl Marx among others. At the end of the 20th century, the social capital term has come to prominence once again especially with the works of Robert Putnam. Today, it is accepted as a centrally important determinant of the long-term economic growth.

This paper summarizes the social capital concept in the historical context. The paper also reports statistically significant and positive relationship between the social capital (measured as interpersonal trust) and growth in four of the six newly industrialized countries: Turkey, Brazil, India and China.

In brief, there are non-negligible intellectual discussions and statistical evidence to make one assume the existence of a meaningful correlation between the economic performances of the countries and their social structures, everything else the same.

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