Kiron, David. "Overview Essay: Economics and the Good, II: Community," Part VI, Frontier Issues in Economic Thought, Volume 3: Human Well-Being and Economic Goals. Island Press: Washington, D.C. 1997. pp.203-210.

Social Science Library: Frontier Thinking in Sustainable Development and Human Well-being

"Economics and the Good, II: Community" by David Kiron

Economic textbooks typically describe individuals as rational, self-interested agents who spend their lives satisfying their own preferences. Yet, as many critics have pointed out, this conception of the economic actor neglects the influence of social relations and institutions, assuming individuals to be undersocialized agents who shape but are not shaped by social arrangements and cultural values. Of course, economists have long recognized that a trusting citizenry, the existence of strong social norms, and a sympathy for human values can mediate efficient outcomes, but the relationship between economic activity and social structure remains, by and large, a mystery that is little understood within modern economic theory.

Since the early 1970s, economists have made numerous attempts to locate the production and maintenance of trust, norms, and moral values within the paradigm of neoclassical economic theory. The articles in this section provide an overview of the issues that economists confront when trying to understand the impact of social organization and social relations on the economy and the impact of economic activity on social arrangements. Three questions emerge from this collection of articles. First, what evidence indicates that social structure is relevant to economic success? Second, what are the advantages or disadvantages associated with applying economic models of human behavior to social problems, such as crime, or to efforts to promote a community's willingness to accept certain necessary, but locally undesirable projects, such as prisons or hazardous waste facilities? Finally, is the economist's "undersocialized" conception of human motivation sufficiently flexible to accommodate social influences, or must it be abandoned and replaced?

In the economics literature, one optimistic approach to all of these questions is to argue that social organizations, out of which values and norms emerge, follow the same principles of rationality that regulate human economic behavior. Proponents of this new institutional economics school attempt to explain the development of social institutions and arrangements as efficient solutions to certain types of social problems. They advocate policies to solve social problems using standard economic assumptions about human behavior.[1] On the one hand, this approach recognizes the economic importance of social relationships, but on the other hand, it simply transfers an undersocialized conception of economic agents to a social setting: abstracting away from the culture and history of concrete interactions and characterizing individuals in a stylized way.[2]

STRONG COMMUNITIES, ECONOMIC VITALITY

Reprinted with permission from Island Press, © 1997

The idea that social relations, especially political activity, is a critical factor in a community's economic success has been strongly urged by Robert Putnam, who argues that a community's social capital can be a critical force behind economic growth.[3] Social capital exists in various forms: as obligations and trust, as social norms and conventions, and as networks through which information is exchanged. It allows groups of people to accomplish things they could not do individually. Unlike other forms of capital, no one individual possesses social capital; it is a functional feature of relations among social structures, such as friends, community organizations, and governments. Similar to a public good, its benefits may accrue to those who do not contribute to it. As a moral resource, the more it is used the more plentiful it becomes. It can enhance the efficient allocation of community resources by fostering reciprocity norms, by facilitating trust information, and by providing the means to solve problems of collective action.

Putnam argues that when similar government institutions were established in different Italian regions in 1970, the relative success of each could be explained by the regional quality of civic engagement. Communities that had a history of strong associational networks and trustworthy leadership were successful, and those with weak civic activity and untrustworthy leaders did poorly. Putnam's central point is that communities become rich because they are civic, rather than the reverse. Similar findings emerge from studies of rural development, of rapid growth countries in East Asia, and of urban renewal projects: development strategies that build social networks or enhance preexisting ones are successful, while those programs that tend to destroy social capital do less well. Putnam concludes that informal structures such as social networks and grassroots associations, as well as political involvements, can be critical for economic success.

Some economic writings resonate with Putnam's findings that economic success depends on community vitality. For example, Sen defends the view that successful operation of an exchange economy depends on mutual trust and implicit norms. When these behavioral modes are plentifully there, it is easy to overlook their role. But when they have to be cultivated, that lacuna can be a major barrier to economic success. This can be illustrated by (1) the development problems of the third world, (2) problems of economic reform in the second world, and (3) variations in productivity and corruptibility in the first world.[4]

Social capital may also contribute to economic success through its impact on individuals. Many economists argue that higher productivity levels can be brought about not only through improvements of physical capital, such as tools and machines, but also through improvements of human capital, such as changes in the skills and abilities of persons. However, human capital itself is dependent on the social context in which it is formed and sustained. The late James Coleman, a leading proponent of the view that social capital is essential to the functioning of social systems, argued that the development of human capital requires adequate levels of social capital. His findings reinforce the idea that economic strategies that do not build up social capital have little chance of succeeding in the long run.

WHEN ECONOMICS WORSENS COMMUNITY LIFE

Economic activity may not only fail to develop social capital, but may also destroy it. As discussed by Robert Frank and Philip Cook, the explosive growth and proliferation of winner-take-all markets, in which top performers are rewarded much more than close competitors, have

Reprinted with permission from Island Press, © 1997

increased competition among economic actors. As a result, more and more people waste efforts, talents, and skills pursuing the grand prizes awarded to a chosen few in such diverse industries as entertainment, athletics, fiction writing, and education. Another consequence is a wide spread deterioration of cooperation norms that formerly restricted competition. Their policy solution to the inefficiencies and inequalities that result from these markets is to institute social interventions, such as laws, taxes, or social norms, since individuals who have the power are not likely to have the incentive to limit opportunities for a big payoff.

The traditional economic solution to problems of inefficient outcomes is to find the correct incentive structures. Many economists believe that price signals can be used to reduce socially undesirable outcomes, such as criminal activity, or to promote socially desirable outcomes, such as community acceptance of prisons or other not-in-my-back-yard (NIMBY) projects. Attach costs to crime, and demand for it will drop. Or, offer sufficient compensation to communities, and they will accept socially necessary if locally undesirable projects. The next two summaries criticize such incentive-based approaches to social planning that fail to consider elements of social capital.

Criminal behavior is in many instances a local phenomenon. Without a consideration of the institutional context in which crime occurs, economic approaches can make recommendations that may worsen rather than alleviate crime. Social planners have paid a good deal of attention to Gary Becker's economic model, which assumes that criminal activity among gangs will diminish as the likelihood of getting caught increases. The policy conclusion is obvious: increase police activity to reduce crime. In work summarized here, George Akerlof and Janet Yellen take issue with this approach, arguing that if community values and social norms are not taken into consideration, then policy recommendations based on Becker's model may generate more rather than less criminal activity.

Akerlof and Yellen contend that a crucial deterrent to crime is knowledgeable and cooperative citizens. In their model, gangs are willing to commit crimes only up to the point where they alienate the community in which they reside. Crime reduction strategies that either ignore this dynamic or alienate community members may lead to more crime, especially if the community is surrounded by other high crime areas. In such communities, residents may not want to weaken their neighborhood gang if that makes them vulnerable to gangs operating in nearby areas. Akerlof and Yellen recommend strategies that both foster community integrity and build norms of cooperation between civic institutions.

In the next summary, Bruno Frey demonstrates that incentive based economic approaches fail to explain levels of tax evasion and community willingness to accept nuclear waste facilities in Switzerland. In cantons where trust in the political system is high, levels of tax fraud are low; where trust is low, levels of fraud are high. These differences cannot be accounted for by incentive differences. Also, contrary to economic expectations community willingness to accept a socially undesirable project was diminished by the mere prospect of significant financial incentives. Economic strategies that use incentives as the guiding principle of social planning appear to omit the importance of noncalculating motives (such as intrinsic motivation and civic virtue) that are endogenous and related to an ethical commitment to one's community. Attitudes toward paying taxes or accepting undesirable projects indicate a deeper concern with what

Reprinted with permission from Island Press, © 1997

citizens ought to do, rather than with the potential costs of tax evasion or the benefits of financial remuneration.

Together, these articles offer strong evidence that a thriving community reinforces and is reinforced by a successful economy. Effective social networks, a trusting citizenry, and a commitment to community contribute to the support of socially productive projects and even increases tax returns. Winner-take-all-markets and incentive-based planning undermine norms of cooperation and a sense of community membership. Yet a successful economy does not require community vitality of the sort typically associated with strong communities in Western countries. Certain authoritarian countries in Asia, such as South Korea and Malaysia, have enjoyed economic growth, while placing strict limits on individual liberties.

A strong rule of law prescribes citizen activity by imposing obligations and restricting freedoms, but in liberal societies citizens play an active role in organizing social structure and taking advantage of voluntary organizations. Thus, citizenship occupies a significant place within liberal societies and may be a central feature of the relationship between social arrangements and economic activity. In their summarized article on citizenship theory, Will Kymlicka and Wayne Norman advance the idea that good citizenship depends on both the preservation of rights and the political exercise of one's obligations and responsibilities to community. Taking stock of the fact that government would be impossible if it were not for responsible citizens, they review how postwar citizenship theory has moved away from an emphasis on rights and toward an emphasis on the value of cultivating a more responsible and politically involved citizenry.

ECONOMIC THEORY AND SOCIAL CAPITAL

The final group of articles considers how economists might accommodate within the existing framework of economic theory such concepts as trust, social norms, and moral values. In the next summarized article, Partha Dasgupta analyzes the production, exchange, and use of trust as a commodity. His main point is that a rational, self-interested individual will pay to acquire trust by investing in his or her reputation. The market provides incentives even to dishonest people to build a reputation as trustworthy, especially if they expect to live a long time in a close-knit community. Similarly, Frank has argued that being known as honest is helpful in situations where partners are being sought.[5] However, community investment in trust tends to achieve less than ideal levels, since no one person invests to make others more trustworthy.

A more expansive view of trust production is suggested by sociologist Mark Granovetter who argues that the formation of trust has less to do with self-interest than with the fact that mutual obligations and psychological bonds develop from repeated exchanges.[6] In his view, economic actors not only care whether someone is reliable or trustworthy (as argued by Dasgupta and Frank) but also want trusted sources from which to obtain this information. That is, individuals are often interested in obtaining information from trusted members of their community, such as friends and family. Although consumer decisions based on this advice sometimes lead to unwise purchases,[7] looking to such sources for information often saves time and permits individuals to focus on other more important decisions.

In fact, people seldom investigate all possible alternatives and calculate which would optimize results: if they did little would be accomplished. As Koford and Miller note, "life would be too

Reprinted with permission from Island Press, © 1997

complex if agents had to carefully consider each daily action from an optimizing point of view. If, at any given time, people consciously make decisions about only a small fraction of their actions, then it is unlikely that their actions taken together will be optimal."[8] Economist Herbert Simon has for many years pointed out that for reasons such as this individuals adopt decision-making strategies that satisfice rather than optimize results.[9] In the behavioral domain most habits, customs and social norms serve a similar function, reducing complexities in life that would otherwise paralyze action. Koford and Miller argue that an explicit recognition of habits, customs, and norms would lead to an economic model of human behavior that represents individuals as satisficers rather than maximizers.

Currently, economists tend to emphasize the rational nature of social norms, explaining their existence in terms of either selfish interests, collective interest, or genetic fitness. In other social sciences, researchers are more diverse in their opinions about the origins and purposes of norms. A rationalistic approach is discussed by Coleman who analyzes norms as a type of social capital that results from externality-producing actions.[10] In his view, norms tell individuals or groups what should or should not be done--they prescribe or proscribe actions. Norms can be internalized, i.e., learned so well that they become a routine part of life; or followed for such external reasons as seeking social approval or avoiding disapproval; or violated and either internally sanctioned (e.g., guilt) or externally sanctioned (e.g., ostracization). A less rationalistic approach to norms is developed by political scientist Jon Elster who contends that many norms exist for reasons that have little to do with instrumental rationality: some norms remain in use long after they served their original purpose, while others arise randomly.[11]

Economists usually represent norms and values within the standard microeconomic theory of behavior as either preferences, constraints or decision rules. In the final summarized article, economist Robert Goldfarb and philosopher William Griffith assess these three approaches and argue that none are entirely successful. Instead of trying to fit such nebulous concepts as values and norms into utility functions, or to interpret norms as decision rules, economists ought to begin with a more robust theory of human behavior. Goldfarb and Griffith are less sanguine than other economists represented in this section about the prospects of expanding the neoclassical paradigm to accommodate norms and values. They align themselves with Amitai Etzioni, Sen, and Hirschman in "refusing to accept the defensive posture of shielding basic assumptions in economics from direct evaluation, criticism, and potential revision..."[12]

Trust, social norms, and moral values--the main ingredients of social capital--constitute part of the social glue that holds society together, but economists have only recently begun to grapple with the relationships between these elements and economic activity. The neoclassical model constructs a social welfare function by aggregating up from individual welfare, yet it may well be that social welfare is a much more dynamic entity than this. As the articles in this section suggest, social structure also has a downward impact on individual welfare. Thus, the interactive forces that shape social capital and human interests may not prove amenable to economic theories of well-being based on individualistic preferences. Consequently, as economists become more interested in and gain a fresh perspective on the elements of social capital, it is questionable whether the economist's tool kit can be expanded to include them.

Notes

Reprinted with permission from Island Press, © 1997

1. An approach sometimes referred to as "economic imperialism." For instructive discussions of this movement, see G. Radnitzky and P. Bernhoz*, Economic Imperialism: The Economic Method Applied Outside the Field of Economics* (New York: Paragon House, 1987); also Jack Hershleifer, "The Expanding Domain of Economics," *American Economic Review Directory* (December 1985), 53-68.
2. This argument is developed in Mark Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness," *American Journal of Sociology* 91(1985), 481-510.
3. As discussed earlier, the idea of social capital and its central role in the structure and function of social systems is developed in great detail by the late sociologist James Coleman.
4. Amartya Sen, "Moral Codes and Economic Success," Discussion Paper no. 49, Development Economic Research Programme, Suntory-Toyota International Centre for Economics and Related Disciplines (London, 1993).
5. Frank, Robert, "If *Homo Economicus* Could Choose His Own Utility Function, Would He Want One with a Conscience?" *American Economic Review* 77(1987), 593-604.
6. Granovetter, *op. cit.*
7. Akerlof has argued that trusting information from friends may not produce optimal results. See George Akerlof, "Procrastination and Obedience," *American Economic Review* 81(1991), 1-19.
8. Kenneth J. Koford and Jeffrey B. Miller "Habit, Custom, and Norms in Economics" in *Social Norms and Economic Institutions,* eds. Kenneth J. Koford and Jeffrey B. Miller (Ann Arbor: University of Michigan Press, 1991), 21-38. The quotation is from p. 24.
9. Herbert Simon, *Reason in Human Affairs* (Palo Alto: Stanford University Press, 1983).
10. James Coleman, "Norms as Social Capital," in *Economic Imperialism: The Economic Method Applied Outside the Field of Economics*, eds. G. Radnitzky and P. Bernhoz (New York: Paragon House, 1987), 133-153.
11. Jon Elster, "Social Norms and Economic Theory," *Journal of Economic Perspectives* 4 (1989), 99-117.
12. Robert S. Goldfarb and William B. Griffith, "The 'Theory as Map' Analogy and Changes in Assumption Sets in Economics," in *Socio-Economics:Ttoward a New Synthesis*, eds. Amitai Etzioni and Paul R. Lawrence (New York: M. E. Sharpe, 1985), 105-130. The quotation is from p. 107.

The works of cited authors are, respectively:

- Amitai Etzioni, "The Case for a Multiple Utility Conception," *Economics and Philosophy* 2 (1986), 159-183;
- Amartya Sen, "Rational Fools" (1977) (see review essay of Sen's work in Part V); and
- Albert O. Hirschman, "Against Parsimony" (1985) (see Part V for summary and full citation).

Reprinted with permission from Island Press, © 1997