27. Social Capital, Social Norms and the New Institutional Economics

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Douglass North (1990) describes institutions as the rules of the game that set limits on human behavior, now a universally-accepted definition. North and others especially underline the crucial role of informal social norms. They predict that, like all rules of the game, social norms should affect the economic prosperity enjoyed by individuals and countries—that they should have a crucial impact, for example, on economic and political development. In fact, substantial evidence demonstrates that social norms prescribing cooperative or trustworthy behavior have a significant impact on whether societies can overcome obstacles to contracting and collective action that would otherwise hinder their development. Much of this evidence comes from outside the new institutional economics, emerging instead from scholarly research in the field of "social capital." A review of this evidence, and its implications for our understanding of the role of social norms and institutions, is therefore the focus of this chapter.

The definition of social capital is contentious, but Woolcock's encompasses most of the literature when he defines it as the norms and networks that facilitate collective action (Woolcock 1998).[1] This distinction between norms and networks corresponds roughly to Uphoff's (1990) distinction between "cognitive" and "structural" manifestations of social capital. This chapter emphasizes work related to the first half of the definition, norms, but we also discuss research more firmly rooted in the second half, networks. In particular, we review social

[1] Putnam (1993: 167) defines social capital as "features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions." Most uses of the term in the literature, however, do not limit it to those norms and networks that improve social efficiency. Coleman (1990, ch. 12) defines social capital in terms of the quantity of obligations or informal "credit slips" between parties that are likely to be repaid, thus implicating both networks (extent of obligations) and norms (which affect likelihood of repayment). Social capital that is productive for some purposes may be useless or destructive for others (Coleman, 1990: 302). For discussions of the definition and history of the term "social capital," see Woolcock (1998) and Sobel (2002), who respectively provide a sociologist's and economist's perspective. Durlauf (2002) and Portes (1998) criticize the use of vague and inconsistent definitions of social capital in the literature; Sobel (2002) agrees but argues that "a vague keyword is not sufficient reason to condemn a promising line of research."

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capital research examining the role of trust and trustworthiness in economic and political development; the effect of social norms on the financing of public goods; the role of voluntary association in building socially beneficial norms; and the role of social heterogeneity in undermining them. The importance of networks, including the voluntary associations stressed by Putnam (1993), is considered primarily in the context of the emergence and impact of norms, and we do not address the literature focusing on the informational advantages of networks.

Social norms "specify what actions are regarded by a set of persons as proper or correct, or improper and incorrect" (Coleman, 1990: 243). Norms and their accompanying potential rewards (for compliance) or punishments (for noncompliance) are not the *sole* determinants of decisions by rational actors, but they "affect the costs and benefits which individuals taken into account when exercising choice" (Coleman, 1987: 135). Norms have no legal or other formal basis, and may sometimes even be in conflict with laws (Coleman, 1990: 243). Norms defined in this way can apply to various social settings with a range of payoff structures. For example, norms can take the form of conventions, resolving coordination problems, such as prescribing that one should drive on the right hand side of the road. As used in this chapter, however, "norms" will be used more restrictively to apply to collective action problems with risks of opportunism, specifically the two prisoner's dilemma variants with the most frequent real-world applications, voluntary provision of public goods and principal-agent games (sometimes called one-sided prisoner's dilemma or trust games). Trust and trustworthiness are therefore central themes in the literature discussed here.

Three conclusions emerge from a survey of this work. First, levels of trust and trustworthiness vary significantly across countries. Second, they have a significant effect on economic outcomes and development. Third, trust and trustworthiness are not simply the product of repeated games and formal institutions, which are the subject of enormous investigation in the new institutional economics and in the social sciences more generally. In order to explain the emergence and sustainability of trustworthy or cooperative behavior in principal-agent or voluntary public goods provision settings, one needs to examine as well such phenomena as the dynamics of social ostracism or participation in "dense horizontal networks."

In the first part of this chapter, we document wide variation in trust and trustworthiness across countries and individuals. This variation potentially explains why only some individuals or countries can undertake or sustain exchanges that require credible commitment in the economic, political or social realms. Subsequently we review the connections among trust, trustworthiness and credible commitment. The final section of the chapter concerns the large literature on the sources of trust and trustworthiness; we conclude that these attitudes do indeed have a significant normative aspect and cannot be viewed only as emerging from reputational forces or from formal, third party institutions.