



Social Capital, Cooperation, and Economic Performance

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Robert Putnam (1993a, 1993b; Helliwell and Putnam 1995) has argued that the same factors he believes contribute to a healthy polity—social capital and civic engagement—are critical to a healthy economy as well. Putnam's argument consists of three propositions: (1) Economic progress and prosperity require cooperation. (2) A key source of cooperative economic behavior is social capital. (3) Social capital, in turn, is a function of civic engagement. I argue that his emphasis on cooperation is entirely salutary, but that social capital and civic engagement are less integral to achieving economic cooperation than Putnam suggests.

Cooperation and Economic Performance

The notion that nonmarket or extramarket forms of cooperation contribute to economic health is reasonably well established theoretically and empirically (Aoki 1988; Dore 1986, 1987; Hicks and Kenworthy 1998; Kenworthy 1995; Porter 1992; Soskice 1991; Streeck 1992). Economists have long recognized that markets fail under certain conditions, but a host of recent research suggests that there are in fact numerous areas in which competition is usefully complemented by economic cooperation. These include, among others, cooperation between the state and interest groups, between firms and their investors and suppliers, between competing firms, between labor and management, and between functional divisions

within firms. Comparative analysis strongly suggests that cooperation is a key contributor to successful national economic performance in affluent democracies.

Social Capital and Cooperation

But how does such cooperation arise? Putnam's answer is social capital. By this he primarily means trust. There are various ways to conceptualize trust, and Putnam never clearly defines it. His use of the term, however, is similar to the colloquial understanding of it: confident expectations that others will "do the right thing" even when incentives or constraints do not encourage or compel them to do so. Trust enables economic actors to cooperate in prisoners' dilemma-type circumstances, in which each would benefit from cooperation but each has an incentive not to cooperate. "Fabrics of trust enable the civic community more easily to surmount what economists call 'opportunism,' in which shared interests are unrealized because each individual, acting in wary isolation, has an incentive to defect from collective action" (Putnam 1993a:89).

A classic example is employee training. In many instances firms would be better off by providing training for their workers. But each individual firm knows that if it invests in such training, other firms may "poach" its employees (i.e., entice them to leave by offering slightly better pay), thereby enjoying the benefits of better-skilled employees without bearing the cost. Alas, if all companies act rationally and skimp on training, none will have a highly skilled workforce. Another example involves wage-bargaining strategy in a decentralized labor movement. Aggressive bargaining for each individual union is rational on purely defensive grounds, because if workers in other firms win high wage increases there will likely be high inflation, so it needs a comparable pay hike just to break even. And if it succeeds in getting a high wage raise while other unions do not, it will have higher pay in conjunction with low inflation, which is the best outcome among the various possibilities. Regardless of what it believes other unions will do, therefore, the rational choice for each union is to demand a substantial pay increase. Of course, if every union follows this logic there will indeed be high inflation, which will lessen the value of wage gains and reduce the price competitiveness of the country's firms relative to their global competitors.

Social capital, Putnam suggests, makes cooperative behavior reasonable in spite of such incentives. If I trust that nearby firms will not try to poach my employees, I can feel confident spending time and money to train them. If wage negotiators for each individual union can feel assured that others will bargain moderately, they can request modest pay raises

with little fear that their members will see the raise rendered null by high inflation.

The principal empirical evidence on which Putnam draws is the industrial districts of north-central Italy, which feature "networks of collaboration among workers and small entrepreneurs." He also points to the "dense social networks" of East Asian economies such as Japan, South Korea, Taiwan, and China. In these countries, he argues, well-developed trust relationships encourage economic actors to cooperate in a variety of productive efforts that fall outside the scope of market relations (Putnam 1993b: 38; 1993a, ch. 6).

Institutional Incentives and Cooperation

There is little question but that trust can contribute to cooperative economic behavior. Trust lubricates economic relationships, making cooperation more likely. Moreover, both trust and economic cooperation have been linked to successful economic performance in quantitative empirical studies (Helliwell and Putnam 1995; Hicks and Kenworthy 1998; Kenworthy 1995; Knack and Keefer 1997). But is trust the principal reason why economic cooperation occurs?

Cooperation can also be induced by *structuring incentives* in such a way that actors no longer face a prisoners' dilemma-type situation. Institutional arrangements such as long-term relationships and formal organization can encourage cooperation whether trust is high or low. In Germany, for example, industry associations require members to fund and participate in the wide-ranging apprenticeship system, which provides classroom and on-the-job training for more than 400 occupations (Streeck 1992). These associations make firms' investments in worker training rational by forcing other firms to make similar investments. Poaching is not entirely eliminated; but because each company is required to train its own workforce in any case, the threat is greatly reduced. Institutional arrangements also help to overcome the wage-bargaining prisoners' dilemma. Where wage negotiations are conducted by a single national confederation or heavily influenced by a relatively small number of unions, these bodies have a strong incentive to bargain moderately, since much of the cost of excessively high wage gains—higher inflation or unemployment, or reduced international competitiveness—will eventually be borne by those they represent. Union coordination, when combined with coordination on the business side, thus tends to encourage wage restraint. This helps explain why the rate of wage increase has been more moderate in nations such as Austria and Norway than in Italy or the United Kingdom (Crouch 1985; Soskice 1990; Kenworthy 1996).

I have argued in more detail elsewhere (Kenworthy 1995, ch. 6) that there are nine chief types of economic cooperation that can be expected to enhance economic welfare and progress. For each type, there are institutional arrangements utilized in various nations that effectively foster cooperative behavior without relying upon trust. Centralized business confederations help to reduce rent-seeking by individual firms and industries. Coordinated wage bargaining, facilitated by a centralized and/or concentrated union movement, encourages wage restraint. Cooperation between government and interest groups, fostered by coordination within interest groups and among government agencies, generates productive, coherent state policies. Long-term, voice-based relationships between firms and their investors permit long time horizons for management. Long-term, voice-based relationships between purchaser and supplier firms foster heightened communication and greater supplier willingness to invest and raise productivity. Selective incentives and other supports provided by industry associations and/or governments encourage alliances among competing firms, which lead to greater investment in research and development and employee training, permit quicker agreement on standards, and provide assistance with matters such as financing, technology diffusion, design, accounting, and marketing. An employment guarantee by firms generates greater cooperation between labor and management; workers tend to be more willing to share valuable knowledge, accept productivity-enhancing technology, and upgrade skills. Participatory teamwork arrangements, by encouraging employees to monitor their peers to prevent shirking, engender greater work effort. Multidivisional teams that link various departments within firms yield a quicker, more effective transition from research and development to production. Table 1 summarizes these nine forms of cooperative behavior, the resulting economic benefits, and the institution(s) promoting the cooperation.

But isn't trust critical to creating such cooperation-inducing institutions in the first place, as Putnam (1993a) and others (e.g., Fukuyama 1995a; Swank 1996) contend? Sometimes yes, but often no. In many instances these institutions are the (intended or unintended) results of historical struggles and compromises. For example, it is sometimes suggested that large Japanese firms offer workers an employment guarantee because management can trust workers to hold up their part of the bargain by working hard (Fukuyama 1995a). But Japan's lifetime employment system grew out of a compromise solution to a series of bitter labor-management struggles following World War II (Kenney and Florida 1988). Once it was created, the system became self-reinforcing. Management in most firms sticks to it because it heightens employee commitment and because a firm that began to lay off employees would quickly develop a bad reputation, making it difficult to attract strong new recruits. Employees work hard for two reasons:

TABLE 1. Economic Cooperation and Institutional Incentives

<i>Actors cooperating</i>	<i>Economic benefits</i>	<i>Institution(s) promoting cooperation</i>
1. Firms across industries	Reduced rent-seeking	Centralized business federation
2. Unions	Wage restraint	Centralized and/or concentrated labor movement
3. Government and interest groups	Coherent, productive government policy	Unified government and centralized interest group organizations
4. Investors and firms	Extended time horizons for firms	Long-term commitment by investors—a product of investors having large ownership stakes and a means of effectively influencing company decision making
5. Purchaser and supplier firms	Heightened communication, greater supplier willingness to invest and raise productivity	Long-term commitment by purchasers
6. Competing firms	Greater investment in R&D and employee training; quicker agreement on standards; assistance with financing, technology diffusion, design, accounting, marketing, etc.	Industry trade associations and/or government incentives
7. Labor and management	Greater willingness on the part of workers to share valuable knowledge, accept productivity-enhancing technology, and upgrade skills	Long-term commitment by employers (employment guarantee)
8. Workers	Heightened work effort	Participatory work teams
9. Functional departments within firms	Quicker, more effective transition from R&D to production	Multi-divisional teams that link departments along the production chain

They know they will be with the company for a long time, so they have an incentive to improve the company's fortunes. Also, the employment guarantee is not absolute, and there is a strong incentive to avoid having to start over with a new firm because pay is based heavily on seniority.

Centralized union confederations arose in Scandinavia not because of "propensities for group membership and collective organization" (Swank 1996:669), but rather in response to the formation of centralized employer confederations, themselves a product of industry concentration and reliance on external trade (Swenson 1991). Once created, these encompassing organizations found it advantageous to coordinate wage bargaining. Although such arrangements have broken down in some countries at various points, on the whole they have been remarkably resilient (Lange, Wallerstein, and Golden 1995).

In the same way, cooperation between firms and their investors in Germany, Japan, and a number of other nations emerged in response to underdeveloped capital markets, which forced companies to rely heavily on large investors (Zysman 1983). It is also the product of lenient financial regulations, in contrast to the United States where laws have strongly discouraged financial institutions from holding large equity stakes in nonfinancial companies. Again, because long-term investor-firm relationships have virtuous consequences for both parties, once created they tend to be self-reinforcing. Trust can certainly help to foster such relationships, but they can occur even if trust is limited.

Perhaps most telling in this regard, Putnam (1995a, 1996) argues that trust has been declining in the United States over the past generation. But if that is so, and if trust is the key to cooperative economic behavior, how can we account for the fact that American firms have only recently begun to experiment with some important types of cooperation, such as research and development alliances, long-term partnerships with suppliers, employee participation, and multidivisional teams? The answer is simple: Firms have been searching for new ways to compete more effectively, and these are among the strategies some have decided to try (Applebaum and Batt 1994; Byrne 1993a, 1993b; Smith 1995; Waterman 1994). To the extent these efforts generate cooperation and improve performance, they may become self-sustaining. In the process they will likely foster trust, but such trust will be largely a consequence, rather than a cause, of cooperation.

How closely, then, does trust correlate with economic cooperation? Drawing upon the growing literature on cooperative economic behavior, I have assigned scores of 0, .5, or 1—representing weak, moderate, and strong cooperation, respectively—to each of eighteen affluent, democratic OECD countries for each of the nine types of cooperation shown in table 1 in each year over the period 1960–94 (Kenworthy 1998). Factor analysis suggests that these nine forms of cooperation load on two dimensions: a

macro-level factor and a firm-level factor (Hicks and Kenworthy 1998). The average scores for these two dimensions for each nation are shown in the appendix table. The best available national-level measure of trust comes from the World Values Survey (World Values Study Group 1994), which asks "Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people?" In their cross-national study of the effects of social capital on economic growth, Knack and Keefer (1997) measure trust as the percentage of respondents in each country replying "most people can be trusted" to this question. These figures, for 1980 and 1990, are also shown in the appendix. The correlations in table 2 indicate that there is virtually no association between trust and either of the two dimensions of economic cooperation, which suggests further reason for skepticism regarding the importance of the former in generating the latter.

Trust, then, appears to be a helpful but not a necessary precondition for economically beneficial cooperative behavior. Indeed, each of the principal forms of economic cooperation I have outlined can be traced, in most empirical instances, to institutional incentives that make cooperation the rational choice for economic actors. That is good news for a nation such as the United States where trust is, seemingly, comparatively scarce and on the decline. Despite this malady, American firms have managed to cooperate more extensively in various ways—with suppliers, with competitors, with labor—in the past decade than was previously the case.

Given the apparent lack of association between trust and economic cooperation across nations, it seems unlikely that Knack and Keefer's (1997) finding of a positive effect of trust on economic growth in cross-country regressions is due to trust being simply a proxy for cooperation. Indeed, in analyses reported elsewhere, Kenworthy and Hicks (2000) find that when trust and firm-level economic cooperation are entered together in multivariate

TABLE 2. Correlations among Economic Cooperation, Social Capital (Trust), Civic Engagement, and Economic Performance Measures for Eighteen OECD Countries, 1960–98

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) Macro level cooperation							
(2) Firm level cooperation	.61 ***						
(3) Trust	.16	-.04					
(4) Voluntary organizations	-.28	-.52	.52 **				
(5) Voting	.33 **	-.04	-.10	-.14			
(6) Growth of per capita GDP	.26 *	.58 ***	-.15	-.46	.02		
(7) Unemployment	-.60 ***	-.46 ***	-.28 *	-.07	-.25 *	.09	
(8) Inflation	-.34 **	-.16	.18	-.14	.22	.10	.32 *

* Note: For country scores, variable definitions, and data sources see the appendix.

* p < .10; ** p < .05; *** p < .01 (one-tailed tests).

growth regressions (macro-level cooperation is not related to growth), both variables are positively signed and statistically significant. (The negative *bivariate* correlation between trust and growth shown in table 1 is thus misleading.) This suggests that Putnam and others may be correct in suggesting that trust is economically beneficial but that its benefits work through channels other than cooperation. It may be, for example, that trust makes certain types of growth-enhancing government policies more palatable. Or it could be that trust contributes to growth by facilitating other types of growth-enhancing cooperation than those I have specified here.

Does Civic Engagement Play a Role?

Putnam's primary focus is on civic engagement—participation in voluntary associations, along with activities such as voting and reading newspapers. He argues that civic engagement builds social capital by fostering personal interaction. Repeated interaction facilitates communication and amplifies information about the trustworthiness of others. It also helps to engender “sturdy norms of generalized reciprocity: I'll do this for you now, in the expectation that down the road you or someone else will return the favor” (Putnam 1993b:36–37; 1993a:173–74). For these reasons, according to Putnam, civic engagement is a key source of economic cooperation and prosperity.

For empirical support, Putnam (1993a, 1993b, Helliwell and Putnam 1995) draws on the stark contrast in civic engagement between regions in northern versus southern Italy. For nearly 1,000 years the former have been characterized by greater civic activism—from mutual aid societies to cooperatives, from choral societies to neighborhood associations—than the latter. It is surely no accident, he argues, that the industrial districts so integral to Italy's recent economic progress are concentrated in those north-central regions of the country that feature the most long-standing and extensive patterns of civic engagement. In Putnam's words:

Typically singled out as essential for the success of industrial districts, in Italy and beyond, are norms of reciprocity and networks of civic engagement. Networks facilitate flows of information about technological developments, about the creditworthiness of would-be entrepreneurs, about the reliability of individual workers, and so on. Innovation depends on “continual informal interaction in cafes and bars and in the street.” Social norms that forestall opportunism are so deeply internalized that the issue of opportunism at the expense of community obligation is said to arise less often here than in areas characterized by vertical and clientelistic networks. What is crucial about these small-firm industrial districts, conclude most observers, is mutual trust,

social cooperation, and a well-developed sense of civic duty—in short, the hallmarks of the civic community. (1993a:161)

I have little quarrel with Putnam's explanation of regional variation in economic performance in Italy. Because the industrial districts of north-central Italy are centered upon multitudes of small firms which interact with one another and with the local labor force in assorted ways, it is reasonable to suspect that social interaction in local sports clubs and choral societies plays an important role in facilitating cooperative economic behavior, and thereby in enhancing economic performance. But how relevant is civic engagement beyond the Italian case? For example, how helpful is civic engagement in accounting for economic performance differences among the affluent industrialized nations?

There is reason for skepticism. Industrial districts, though not unique to northern Italy, are not nearly as prominent in any other affluent nation. Furthermore, if trust is of limited importance in fostering the types of cooperative economic behavior that *are* prominent in some other countries, civic engagement may have little to contribute. Civic engagement cannot help us to understand why Austrian labor unions consistently moderate their wage demands, or why large Japanese firms successfully build long-term relationships with their suppliers, or why German banks forge long-term partnerships with firms of which they are part-owners, or why some American companies such as Procter & Gamble make effective use of self-directed work teams.

Two indicators of civic engagement are available to help us explore this issue. One is the average number of voluntary organizations in which people participate. These data, like those for trust, are from the 1981 and 1991 World Values Surveys (Knack and Keefer 1997). Respondents were asked if they had volunteered for any of the following types of organizations in the past year: social welfare services for elderly, handicapped, or deprived people; religious or church organizations; education, arts, music, or cultural activities; trade unions; political parties or groups; local community action on issues like poverty, employment, housing, and racial equality; Third World development or human rights; conservation, the environment, ecology; professional associations; youth work (e.g., scouts, guides, youth clubs). These figures represent the best available cross-national measure of participation in civic associations. (Indeed, they seem preferable to the measure Putnam uses in *Making Democracy Work*: the number of organizations per capita in a region [Putnam 1993a:91].) The second indicator of civic engagement is average voter participation (as a share of eligible voters) over the period 1945–89 (Lane and Ersson 1990). Although voter turnout seems less clearly linked to trust and economic cooperation, the degree to which citizens are willing to participate in the

electoral process may tell us something about the prominence of civic participation norms that foster trust.

Table 2 shows that the voluntary organizations measure is positively associated with trust, as Putnam would expect, though the same is not true for voting. There appears to be little or no relationship between civic engagement and economic cooperation itself. Since the small firm-based economic cooperation that characterizes northern Italian industrial districts is of limited relevance in most other industrialized nations, this is not especially surprising. Table 2 also shows correlations between these indicators of civic participation and 1960-98 period averages for three major components of economic performance: growth of per capita GDP, unemployment, and inflation. They suggest that civic engagement has not contributed to successful national economic performance in recent decades. The only indication of a beneficial effect is a marginally significant inverse association between volunteering and inflation. Results of regression analyses (not shown here) that include commonly used control variables, and examine subperiods of years (e.g., 1960-73, 1974-79, 1980-89, 1990-98) separately, suggest the same conclusion.

Conclusion

There is a good deal of merit in Putnam's discussion of the economy. He is right to emphasize the importance of cooperation as a complement to market competition. And it is certainly true that trust can help to promote cooperative behavior. But in his exclusive focus on trust as a source of cooperation, and on civic engagement as a source of trust, Putnam makes too much of the Italian case. Differences in civic engagement may help to account for the variation in economic performance trends between northern and southern Italy in recent decades, but they are of no help in explaining such variation across the affluent democracies over that period. This may be because civic activism is not a precondition for the formation of trust among economic actors, or because trust itself is not the key to cooperative economic behavior. The argument and evidence I have presented here suggest both.

APPENDIX

Country Scores for Economic Cooperation, Social Capital (Trust), Civic Engagement, and Economic Performance Measures

	Macro level cooperation	Firm level cooperation	Trust (%)	Voluntary organizations	Voting (%)	Growth of per capita GDP (%)	Unemployment (%)	Inflation (%)
Australia	.208	.057	47.8	1.01	92	2.2	5.5	5.9
Austria	.957	.271	31.8	.76	92	2.8	2.6	4.0
Belgium	.721	.271	30.2	.56	87	2.8	6.7	4.3
Canada	.089	.057	49.6	1.03	75	2.3	7.5	4.8
Denmark	.749	.271	56.0	.97	85	2.5	5.3	6.1
Finland	.862	.396	57.2	.40	78	2.9	5.6	6.4
France	.414	.086	24.8	.42	76	2.6	6.3	5.6
Germany	.807	.414	29.8	.74	85	2.6	4.4	3.3
Ireland	.120	.057	40.2	.85	73	4.2	9.7	7.3
Italy	.414	.457	26.3	.38	88	3.0	8.1	7.9
Japan	.762	.932	40.8	.38	72	4.5	2.1	4.7
Netherlands	.638	.075	46.2	1.11	88	2.3	5.1	4.2
New Zealand	.183	.057			89	1.3	3.2	7.4
Norway	.963	.386	61.2	1.09	81	3.2	2.5	5.9
Sweden	.955	.336	57.1	1.08	86	2.0	3.3	6.1
Switzerland	.551	.271	43.2	.73	59	1.4		3.5
United Kingdom	.135	.075	44.4	.92	77	2.1	5.6	7.0
United States	.069	.111	45.4	1.50	59	1.9	5.9	4.6

Note: Macro level cooperation = average score on cooperation types 1-4 and 7 in Table 1, 1960-94 (Kenworthy 1998). Firm level cooperation = average score on cooperation types 5-6 and 8-9 in Table 1, 1960-94 (Kenworthy 1998). Trust = percentage responding "most people can be trusted," 1980 and 1990 (Knack and Keefer 1997: 1285). Voluntary organizations = average number of voluntary organizations per respondent, 1980 and 1990 (Knack and Keefer 1997: 1285). Voting = average share of eligible voters voting in national elections, 1945-89 (Lane and Ersson 1990). Growth, unemployment, and inflation = averages for 1960-98 (OECD 1997, n.d.).

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